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Annual Review of developments in English oil and gas law

2017 Edition

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Contents

Introduction

Welcome to the 2017 edition of the CMS Annual Review of developments in English oil and gas law

Whilst times remain tough in the oil and gas sector, the past twelve months have seen an uptick in deal activity. At CMS we have seen a noticeable shift to deals at the more innovative end of the spectrum with new players on the buy-side, creating exciting challenges for oil and gas transactional lawyers. The industry around the world continues to be challenged by a relatively low oil price which has meant that some of the more accepted transaction structures and market positions have had to change.

The Annual Review has, I hope, been put together to be useful for you and your colleagues. We continue to focus on recent developments that might affect all of us who practise in the oil and gas sector. We hope that you find this Annual Review interesting and of assistance in navigating some of the new complexities in the industry.

If you have any queries or questions, please do not hesitate to contact us.

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From the editor

Once again, there is no shortage of material for inclusion in the 2017 Annual Review. In the past twelve months, we have seen case law that impacts almost every aspect of oil and gas legal work – spanning JOAs, M&A deals, commodity, sale and purchase agreements and much more.

As always, some updates included in this Annual Review might impact multiple areas of practice or relate to numerous issues. For example, some of the cases in the section on drilling units, FPSOs, tankers and support vessels could just as easily have found a home in a section on termination of contract. In that respect, the chapter headings are purely for convenience.

I would like to thank the editorial team of Alexandra Scott, Anna Rose and the wider CMS support teams for their hard work in making this year's edition of the Annual Review happen. I would also like to thank the many contributors across CMS for their thoughts and assistance. Each year I have edited the Annual Review, I have started the year concerned that there might not be enough material for a publication, but ended the year managing down the content to a realistic size. As litigation in the sector continues, it seems likely that the English Courts will continue to give guidance useful to us all for years to come.

I hope that you find this Annual Review useful. Please do let us have any feedback.

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LNG, natural gas and oil sale and purchase agreements

Notwithstanding a degree of price stability, the hydrocarbons commodity markets have continued to suffer over the past twelve months. These difficult times have ensured that there is no shortage of interesting guidance from the English Courts concerning the interpretation of commodity sale and purchase agreements.

— In *Scottish Power UK PLC v BP Exploration Operating Company Ltd and Others* [2016] EWCA Civ 1043, the Court of Appeal considered whether a 'Default Gas' remedy extinguished a right to common law damages.

— In relation to price reviews (or reopeners), the High Court in *Associated British Ports v Tata Steel UK Ltd* [2017] EWHC 694 (Ch) considered whether to declare unenforceable a price review provision as an 'agreement to agree'.

— In *Ampal-American Israel Corp. et al v Arab Republic of Egypt* (ICSID Case No. ARB/12/11), an arbitral tribunal gave a rare insight into the operations of the termination provisions in a gas sales agreement for non-payment.

— In *Vitol S.A. v Beta Renewable Group S.A.* [2017] EWHC 1734 (Comm), the Commercial Court considered whether a seller was relieved of its obligations to deliver biofuels when the buyer did not nominate a vessel.

Default Gas - exclusive remedy in natural gas sale and purchase agreement

The English Court of Appeal has upheld the Commercial Court's decision that a Default Gas remedy in a natural gas sale and purchase agreement was the sole and exclusive remedy for underdeliveries to a buyer caused by a shut-in for the purposes of constructing third-party access (*Scottish Power UK PLC v BP Exploration Operating Company Ltd and Others* [2016] EWCA Civ 1043). In deciding that the buyers were entitled to compensation for the underdeliveries caused by the shut-in, the Commercial Court had highlighted the dilemma likely to be faced by the North Sea industry implementing the obligations in the Energy Act 2016 to maximise economic recovery on the UKCS ('**MER UK**'). The Court of Appeal emphasised the importance of the drafting of the contractual structure in dealing with damages and/or compensation for contractual breaches resulting in underdeliveries. As similar provisions are used in many natural gas sale and purchase agreements internationally, the decision will be of interest to a wide range of natural gas buyers and sellers with long-term natural gas sale and purchase agreements.

Facts

Scottish Power UK PLC ('**Scottish Power**') entered into four long-term agreements (on materially identical terms) for the sale and purchase of natural gas ('**Agreements**'), whereby it agreed to purchase from the sellers (BP Exploration Operating Company Limited, Talisman Sinopec North Sea Limited, ENI TNS Limited and JX Nippon Exploration and Production (UK) Limited (the '**Andrew owners**' or the '**Sellers**')) natural gas produced from the Andrew Field.

The obligation to deliver an amount of natural gas in accordance with Scottish Power's proper nomination was contained in Article 6.12 of the Agreements, which provided that:

> *'the Seller shall deliver on each Day at the Delivery Point the quantity of Natural Gas properly nominated by the Buyer under this Agreement for delivery on such Day.'*

Article 16 established a regime whereby, when an underdelivery occurred on any day, the quantity of gas which the Sellers had failed to deliver was classified as Default Gas and the Buyer would become entitled to receive a like quantity of gas in a subsequent month at the Default Gas Price, which was 70% of the Contract Price.

The provision at the centre of the dispute was Article 16.6, which stated:

> *'The delivery of Natural Gas at the Default Gas Price and the payment of the sums due in accordance with the provisions of Clause 16.4 shall be in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law on the part of the Buyer against the Seller in respect of underdeliveries by the Seller under this Agreement, and save for the rights and remedies set out in Clauses 16.1 to 16.5 (inclusive) and any claims arising pursuant thereto, the Buyer shall have no right or remedy and shall not be entitled to make any claims in respect of any such underdelivery.'*

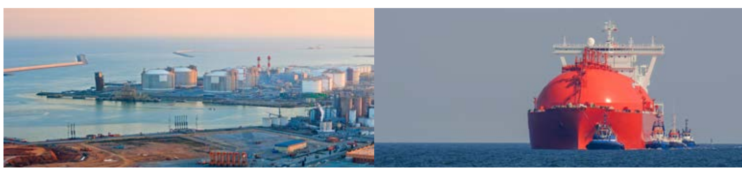
The agreements also provided a Reasonable and Prudent Operator ('**RPO**') standard at Article 7.1, which required:

> *'Throughout the Contract Period the Seller will, in accordance with the Standard of a Reasonable and Prudent Operator, provide, install, repair, maintain and operate those Seller's Facilities which are (in the opinion of the Seller and the other Sellers) necessary to produce and deliver at the relevant times the quantities of Natural Gas from the Andrew Field which are required, in accordance with the terms of this Agreement, to be delivered to the Buyer at the Delivery Point.'*

An RPO was defined in Article 1 as:

> *'a Person seeking in good faith to perform its contractual obligations and, in so doing and in the general conduct of its undertaking, exercising that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be expected from a skilled and experienced operator engaged in the same type of undertaking under the same or similar circumstances and conditions, and the expression the 'Standard of a Reasonable and Prudent Operator' shall be construed accordingly.'*

Production of natural gas was shut-in for a period of over three and a half years, between 2011 and 2014, so that work could be done to tie-in a nearby oil and gas field to the Andrew platform.



In summary, the Andrew owners broadly accepted that their failure to deliver gas to Scottish Power was a breach of Article 6.12 of the Agreements. It was common ground that the sole remedy for any breach of that clause was Default Gas under Article 16. However, it was Scottish Power's case that, during the relevant period, the Andrew owners were also in breach of their obligation under Article 7.1 to operate the Sellers' Facilities, for which it was entitled to separate damages.

The Commercial Court decided that the Andrew owners were in breach of the Article 7.1 RPO obligation to operate the Sellers' Facilities, but Scottish Power's remedy for that breach was limited to the Default Gas Price. There was no separate right to damages at common law.

Scottish Power appealed its right to common law damages to the Court of Appeal.

Court of Appeal Decision

Scottish Power contended that in refusing to grant a separate remedy of damages for a breach of Article 7.1, the Commercial Court had lost sight of the fact that there is a presumption that the parties do not intend to give up rights or claims which the general law gives them: *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689; that clear words are required to exclude or limit that right; and that, since the Commercial Court had held that there were two possible meanings to the Article, it should have adopted the meaning which did not involve Scottish Power losing what may be very valuable rights – said to amount to up to £85 million.

However, the Court of Appeal did not regard the Commercial Court as having erred. It decided the fact that there are two possible meanings to the Article is the beginning of the inquiry, not its end. It is then necessary for the Court to apply '*all its tools of linguistic, contextual, purposive and common sense analysis to discern what the clause really means*'. If, as a result of so doing, the answer becomes clear, the Court should give effect to it, even though the interpretation may deprive a party of a right at law which it might otherwise have had. It is open to the parties to make an agreement which has that effect.

The Court of Appeal considered that the Agreements clearly did displace Scottish Power's rights. The Court of Appeal decided that '*Article 16.6 is not a pure exclusion clause. It is a clause which replaces common law rights with a different contractual remedy, which may, in certain circumstances, be more valuable than the right to damages*'. Its reasons for reaching this conclusion were:

- First, the Agreements were carefully drafted and long-term contracts. Article 16 lays down what is in effect a contractual remedial regime in respect of underdeliveries which by Article 16.6 is intended to be comprehensive and to the exclusion of any other remedy. It would be '*odd*' if a breach of Article 7 provided an additional remedy, as it would result in Article 16.6 having a confined application to a limited number of circumstances – particularly in the context of the force majeure clause, meaning that any non-negligent mishap is likely to be already excluded from the application of Article 16.6.
- Second, it seemed unlikely that a reasonable person would intend the words '*rights, remedies and claims howsoever arising … in respect of underdeliveries*' in Article 16.6 to apply only to claims where an actual nomination and consequent underdelivery was an essential ingredient of the claim.
- Third, the words '*...in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law on the part of the Buyer against the Seller*' relate in effect to causes of action (every possible one) and the rights, remedies and claims arising therefrom, and that the words that follow ('*in respect of underdeliveries*') refer to the factual consequences of the breach of contract or duty in respect of which the relevant right, remedy or claim arises. Contrary to Scottish Power's submissions, they do not mean that an underdelivery following a nomination is a requisite element of Article 16.6 applying.

Comment

As with many natural gas sale and purchase agreements, the Agreements in dispute were '*lengthy and complex documents*'.

On one view, the Court of Appeal simply decided that the Agreements were clear. In the face of this clarity, there was no need to apply *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*. The Court of Appeal might be said to have reached its view on this clarity by applying '*all its tools of linguistic, contextual, purposive and common sense analysis to discern what the clause really means*' and deciding that only one interpretation of the Agreements made sense – which was that Default Gas provided an exclusive remedy for all underdeliveries. As a consequence of the sufficiently clear drafting, Scottish Power had agreed to give up its common law rights to damages for all underdeliveries caused by breach of the Agreements.

However, the reasoning of the Court of Appeal is not entirely clear on the point. The Court of Appeal appears to accept that there might be more than one meaning to the contractual provisions, but then rather than simply favouring the presumption in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*, the Court of Appeal sought to apply '*all its tools of linguistic, contextual, purposive and common sense analysis to discern what the clause really means*'. In this context, the presumption in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* was displaced by a further analysis of the Agreements beyond that which was found in its clear words. Although the difference with the above approach might seem semantic, it is of very real importance to drafting and construing agreements. This approach would arguably downgrade the presumption in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*.

For oil and gas lawyers drafting sale and purchase agreements for natural gas, the drafting lessons from this case appear to be:

- In the context of the MER UK, RPO obligations that require a party to comply with the agreement (without a carve out for complying with competing regulatory obligations) should be considered with care. Such an obligation may place a party in the invidious position of choosing between a breach of contract and breach of regulatory obligation under MER UK to shut-in for constructing third-party access.
- In the absence of clarity on whether express contractual remedies are the sole remedy in the event of breach of contract and negligence, there is prospect for dispute in the event of breach. In natural gas sale and purchase agreements, where Default Gas provisions are commonly included to address underdeliveries, the extent to which those clauses govern underdeliveries caused by breach or negligence will depend upon the exact drafting of the sale and purchase agreement. Parties should consider carefully whether the Default Gas provisions should govern potentially long periods of shut-in caused by a decision of the seller, in breach of contract, to cease producing or merely short term, intermittent, underdeliveries. These are obviously very different circumstances.
- However, the Court of Appeal suggests that broad drafting in a Default Gas provision means that both of these circumstances can, with some ease, be captured in a Default Gas clause and common law damages excluded.

Judges: Moore-Bick LJ, Christopher Clarke LJ, King LJ.

Price review clause not unenforceable 'agreement to agree'

The oil and gas industry continues to experience a significant number of natural gas and LNG price review (or 'reopener') disputes. This could be viewed as an inevitable consequence of the common practice of including provisions in long-term energy contracts to renegotiate price, quantity or other factors over time. In *Associated British Ports v Tata Steel UK Ltd* [2017] EWHC 694 (Ch) the High Court considered whether such clauses were unenforceable 'agreements to agree'.

The oil and gas industry will be relieved that the answer was that they were not. However, the case serves as a useful reminder as to what makes such clauses enforceable (or unenforceable).

Facts

Associated British Ports ('**ABP**') is the owner and operator of Tidal Harbour facilities at Port Talbot in Wales. Around March 1995, it entered into a new licence agreement with Tata Steel UK Limited ('**Tata**') (the '**Licence Agreement**'). Under the Licence Agreement, iron, ore and other commodities that Tata used in its steel works were imported through the Tidal Harbour. The Licence Agreement set out the rights and obligations of Tata and ABP as regards Tata's use of the Tidal Harbour facilities.

Clause 22 of the Licence Agreement contained a renegotiation provision of the type found in many long-term contracts. It stated:

> *'It is hereby agreed between the parties that in the event of any major physical or financial change in circumstances affecting the operation of* [Tata's] *Works at Llanwern or Port Talbot or ABP's operation of the Tidal Harbour on or at any time after the 15th day of September 2007 either party may serve notice on the other requiring the terms of this Licence to be re-negotiated with effect from the date on which such notice shall be served. The parties shall immediately seek to agree amended terms reflecting such change in circumstances and if agreement is not reached within a period of six months from the date of the notice the matter shall be referred to an Arbitrator*

> *(whose decision shall be binding on both parties and who shall so far as possible be an expert in the area of dispute between the parties) to be agreed by the parties or (if the parties shall fail to agree) to be appointed on the joint application of the parties or (if either shall neglect forthwith to join in such application then on the sole application of the other of them) by the President for the time being of the Law Society.'*

In February 2016, Tata purported to give notice under such clause of a '*major financial change in circumstances*' and asked ABP to negotiate some amendments to the Licence Agreement (including a 50 per cent reduction of the fee payable by Tata to ABP). The rationale for such renegotiation was that certain factors, including a doubling in the imports of steel to Europe, a quadrupling of imports from China, increased tariffs by the United States and a strong pound, had all reduced the competitiveness of UK-manufactured steel.

ABP contended that such factors did not fall within the definition of a '*major financial change in circumstances*' since such circumstances regularly impact the steel industry and ABP applied to the English Court for a declaration that, as an *'agreement to agree'*, the clause was invalid, being too uncertain to be enforceable. Tata applied for ABP's claim to be stayed under section 9(1) of the Arbitration Act 1996 on the grounds that the dispute was to be resolved by arbitration under Clause 22 of the Licence Agreement.

Decision

In rejecting ABP's arguments, the High Court found that the wording of Clause 22 of the Licence Agreement was not so uncertain as to be unenforceable. The words amounted to a binding obligation to refer any dispute regarding renegotiation of the terms of the Licence Agreement to arbitration. Therefore ABP's claim should be stayed in favour of arbitration.

The High Court also decided that (absent agreement between the parties) it would be for an arbitrator to determine whether the matters set out in Tata's February 2016 notice amounted to a '*major physical or financial change in circumstances*' entitling Tata to a revision of the terms of the Licence Agreement, and that the scope of any such arbitration would include determination of the licence fee payable under it.

In reaching its conclusion, the High Court noted that where a clause is challenged for being uncertain, it must be decided on its own facts rather than transposing '*a decision in a case in respect of one set of words in one contract to another*'.

The High Court highlighted the line of case law that confirms that the Courts should strive to give some meaning to contractual clauses agreed by the parties if it is at all possible to do so. The High Court also noted Leggatt J's assertion in *Astor Management AG & ors v Atalaya Mining plc & others* [2017] EWHC 425 (Comm) that '*the role of the Court in a commercial dispute is to give legal effect to what the parties have agreed, not to throw its hands in the air and refuse to do so because the parties have not made its task easy. To hold that a clause is too uncertain to be enforceable is a last resort*'.

The Clause clearly fell within a category of cases where the Courts are particularly reluctant to find that a clause was void for uncertainty since the contract had been performed by the parties over a long period of time. Importantly, the inclusion of the Clause made commercial sense for the parties who were in a long-term relationship of mutual interdependence. The 15 September 2007 earliest date for renegotiation indicated the halfway period of the Licence Agreement and represented the first opportunity to reassess the relationship between the parties.

The High Court considered whether the phrase '*any major physical or financial change in circumstances*' was too uncertain for an arbitrator to determine whether the arbitration clause has been validly triggered and whether it was possible to define the boundaries of a class so as to determine whether something was, or was not, a major physical or financial change in the circumstances. The High Court noted that '*provided one can posit some changes which would definitely fall within the scope of the phrase 'major physical or financial change in circumstances' and some changes which clearly fall outside it, then the phrase is sufficiently certain to be enforceable even though it may be difficult in the abstract to draw the precise divide between changes falling on either side of the line*'.

The High Court held that the wording and context of Clause 22 points to the kind of changes that can trigger the right to seek a revision of the Licence Agreement. Meanwhile the questions that an arbitrator would be obliged to consider in determining whether a major change in circumstances had occurred were not impossible to answer. Therefore, the Clause was not so uncertain as to be unenforceable.

Comment

Many long-term energy contracts contain provisions that allow for the renegotiation of price or quantity. Perhaps this is most regularly seen in legacy natural gas and LNG sale and purchase agreements, where parties commonly make provision for price reviews or 'reopeners'.

A price review provision will usually – but not always – require conditions to be satisfied before a review can take place. These conditions are sometimes referred to as 'trigger events'.

Trigger events vary from contract to contract. However, they regularly contain generic wording/a requirement for an event such as 'a significant change in the energy market'. English law has a strong tradition of: (i) enforcing such renegotiation provisions; and (ii) accepting that arbitrators are well placed to resolve issues, such as repricing, that the Courts have traditionally considered outside their jurisdiction. In this respect the Arbitration Act 1996 specifically empowers arbitrators to resolve 'differences' as well as 'disputes', which is generally understood to cover such issues as price reviews.

This case serves as a helpful reminder that:

— First, English law will seek to uphold renegotiation or price review clauses in long-term contracts, where performance has commenced, wherever it is possible to do so.

— Secondly, it will be assisted in doing so if the clause contains objective criteria for the 'trigger' and/or renegotiation objective. An objective criteria to 'trigger' a review and/or define the result of the review need not be specific. The Courts have previously decided a 'reasonable price' would be sufficient to define a new price.

— Thirdly, an arbitration clause mechanism in a contract will assist the Court in finding that a renegotiation provision is enforceable by ensuring that, if the parties cannot agree the issue, then it will be resolved by an arbitrator.

The case is also a reminder that, where there is an arbitration clause, the above issues should be resolved by an arbitrator and not the Courts. In the event court proceedings are commenced, they will be stayed for arbitration.

Judge: Rose J.

Natural gas transportation and sales: international law protection

In addition to contractual protections, it is important that those structuring transactions also consider protections that might be available in international law. In *Ampal-American Israel Corp. et al v Arab Republic of Egypt* (ICSID Case No. ARB/12/11) an arbitral tribunal acting under the auspices of the International Centre for Settlement of Investment Disputes ('**ICSID**'), the World Bank's arbitration institution, was asked to determine whether Egypt was liable (1) for failing to exercise due diligence in protecting against repeated terrorist attacks on a gas pipeline through which the Claimants' investment company exported natural gas from Egypt to Israel; and (2) for expropriating the Claimants' property interests in a free-zone tax licence and a gas sales and purchase contract. The decision gives a useful insight into the interpretation of certain provisions of gas sales agreements and the additional international law protections that may be available for well-structured transactions.

Facts

The Claimants were shareholders of East Mediterranean Gas Company S.A.E. ('**EMG**'), a free-zone company created to purchase natural gas from Egypt and to export it to Israel through a pipeline crossing the North Sinai in Egypt. Egypt conferred to EMG tax-free status under its free zones system until 2025. EMG entered into a long-term upstream supply contract with the state-owned Egyptian General Petroleum Corporation ('**EGPC**')/the Egyptian Natural Gas Holding Company ('**EGAS**'), which was governed by English law and subject to ICC arbitration ('**GSPA**').

The GSPA provided at Article 2.5.2 that:

> *'In the event that Buyer fails to timely pay any amounts due under this Agreement for four (4) consecutive Months, Seller shall be entitled to terminate this Agreement upon delivery of written notice to Buyer, provided that such failure shall not create the right to terminate this Agreement unless Buyer fails to cure such failure within thirty (30) Business Days after receiving notice from Seller of the fourth (4th) consecutive occurrence of such non-payment.'*

Also, at Article 9.4.7:

> *'If a Party has a bona fide dispute with respect to any such sum shown in any invoice (or accompanying statement) as being payable by that Party, then such Party shall (i) pay in full all of the undisputed amount shown in such invoice on or before the relevant due date, (ii) promptly to give notice to the other Party of the amount in dispute and the reasons therefore, (iii) in such notice, inform the other Party whether the Party disputing such amount intends to pay such disputed amount pending resolution of such dispute (in which case such disputed amount shall be paid together with the payment of any undisputed amount), or withhold payment of the disputed amount pending resolution of the dispute. The Parties shall seek to settle the disputed amount as soon as reasonably practicable. Any disputed amount agreed or determined, pursuant to Article 14 to be not payable by the Party disputing such amount shall (to the extent that such disputing Party previously*

> *paid such disputed amount) shall be re-paid by the other Party to the disputing Party (such amount to be included in the Monthly Invoice or Annual Statement, as applicable, next following such agreement or determination, together with the interest on such amount at a rate equal to the Agreed Interest Rate plus three percent (3%) (compounded annually) from the date when such payment was due until and including the date when the disputed amount was settled or decided pursuant to Article 14. Any disputed amounts agreed or determined, pursuant to Article 14, to be payable by the Party disputing such amount shall be retained by the other Party if the disputing Party previously paid such disputed amount, or (to the extent that such disputing Party elected not to pay such disputed amount) shall be paid by the disputing Party to the other Party (such amount to be included in the Monthly Invoice or Annual Statement, as applicable, next following such agreed or determination, together with interest on such amount at a rate equal to the Agreed Interest Rate plus three percent (3%) (compounded annually) from the date when such payment was due until and including the date when the disputed amount was settled or decided pursuant to Article 14'.*

Some years after the signing of the GSPA, the Egyptian government revoked EMG's tax-exempt status. Following the Arab Spring, the Egyptian pipeline system that used to deliver gas to the EMG pipeline suffered a series of sabotage attacks, which the Claimants argued that Egypt failed to prevent and remedy within a reasonable time. Eventually, EGPC/EGAS purportedly terminated the GSPA for alleged non-payment by EMG under Article 2.5.2. EGAS argued that its invoices had not been disputed under Article 9.4.7 and therefore it was entitled to terminate for non-payment of those invoices. It supported its position with expert evidence on English law from Lord Hoffmann.

EMG argued that the termination amounted to a repudiatory breach. In doing so, it argued that even if EMG failed to dispute an invoice it would not change whether an amount was due or not. It also argued that sums were not due over the three months used to justify termination. It supported its interpretation with expert evidence on English law from Sir Bernard Rix.

EMG sought damages before an ICC tribunal for repudiatory breach. In parallel, the Claimants commenced investment treaty claims before ICSID based on the US-Egypt Bilateral Investment Treaty ('**BIT**') claiming for (1) failure to exercise due diligence in protecting against repeated terrorist attacks on a gas pipeline through which the Claimants' investment company exported natural gas from Egypt to Israel, and (2) expropriating the Claimants' property interests in a free-zone tax licence and GSPA.

The ICC tribunal issued its award while the ICSID arbitration was pending and the ICSID tribunal invited the parties to comment on the relevance and impact of the ICC award on the investment dispute.

Decision

In relation to the wrongful termination of the GSPA, the ICC tribunal found in favour of EMG that the GSPA had been wrongfully terminated in repudiatory breach. It favoured the construction of Sir Bernard Rix, meaning that EGPC/EGAS were required to demonstrate that a sum was properly due under the Monthly Payment provisions of the GSPA when properly calculated to rely on Article 2.5.2. It was not sufficient to rely on an invoice not being disputed.

The ICSID tribunal found that the ICC tribunal's findings in relation to the attacks and the termination of the GSPA were binding on the parties in the ICSID arbitration. Nevertheless, the ICSID tribunal conducted its own evaluation of the evidence on those matters and concluded that the ICC tribunal's findings were correct.

In deciding whether wrongful termination of the GSPA amounted to expropriation, the ICSID tribunal decided:

— Whether there has been a breach of the BIT provisions on expropriation and whether there has been a breach of contract are different questions.

— The definition of a protected '*investment*' in the BIT covered expressly '*every kind of asset*', including '*any right conferred by law or contract*'. It follows that the rights conferred by the GSPA were protected investments.

— The BIT prohibited expropriation or nationalisation (or actions tantamount to expropriation or nationalisation), save in specified circumstances.

— It was '*clear*' that Egypt's actions were tantamount to expropriation.

In addition, the ICSID tribunal also found that the wrongful termination of the GSPA was an indirect expropriation as the GSPA's termination was a disproportionate act attributable to Egypt. In particular, the alleged amount due under the GSPA of US$37 million was '*a very relatively small amount having regard to the potential economic benefits to Egypt and EMG's investors…which amount to billions of dollars*'. The ICSID tribunal noted that '*it is well settled that the 'irreparable cessation' of an investment activity caused by a disproportionate act of a State is tantamount to expropriation*'.

It also decided that:

- While Egypt could not have prevented the first terrorist attack on the pipeline, it could have taken preventive or reactive measures in relation to 13 subsequent attacks, and its failure to do so constituted a breach of the '*full protection and security*' standard under the BIT.
- The revocation of EMG's tax exemption was tantamount to an expropriation, falling outside the realm of the ordinary exercise of the State's regulatory power because it '*took away a defined and valuable interest that had been validly conferred according to Egyptian law at the time that the investment was made and that had been guaranteed by the State for a defined period*'.

Comments

The decision of the ICSID tribunal contains a number of features of interest to oil and gas lawyers:

- The ICSID tribunal decision makes public, and agrees with, the decision of the ICC tribunal concerning the operation of the termination provisions of the GSPA. The ICSID tribunal and ICC tribunal agreed that it was insufficient for the terminating party for non-payment to seek to rely on (i) invoices not being paid; and (ii) no notice of dispute being issues concerning those invoices. It must establish that a sum was properly due when calculated in accordance with the GSPA. As such, terminating similar contracts for simple non-payment of sums on invoices which have not been disputed poses a risk if there is an argument that no sum is properly due (even though a notice of dispute was not raised).
- It is apparent that the above view is not universally accepted. The expert evidence provided by Lord Hoffmann reached a different conclusion, which might suggest that alternative interpretations are available and the drafting of such provisions might warrant closer scrutiny.
- Finally, the availability of a BIT claim is a reminder that when structuring international transactions it is sometimes possible to take advantage of international law protections that will provide additional rights and remedies to those found in any contract. As such, careful thought should be given to transaction structures, such as the nationality of the contracting party and its shareholders, as well as the terms of the contract under negotiation.

Arbitrators: Yves Fortier QC, Professor Campbell McLachlan QC, Professor Francisco Orrego Vicuña.

Failure to deliver: Is nomination of a vessel a condition precedent to obligation to deliver?

In *Vitol S.A. v Beta Renewable Group S.A.* [2017] EWHC 1734 (Comm), the Commercial Court considered whether a seller was relieved of its obligations to deliver biofuels when the buyer did not nominate a vessel. As the seller had expressed that it could not deliver and the buyer wished to bring the contract to an end for renunciatory breach, the critical issue made the difference between the buyer having a remedy for the seller's non-performance and not having a remedy at all. The facts of the case serve as a reminder to innocent parties that they should act carefully to preserve their right to bring a contract to an end and claim damages in the face of a counterparty refusing to perform.

Facts

Vitol S.A. ('**Vitol**'), a major oil trading company based in Switzerland, entered into a contract with Beta Renewables Group S.A. ('**Beta**'), a manufacturer of biofuel products, for the delivery of 4,500 metric tonnes of bio fuel at a price of EUR€3,570,750. The contract provided a lifting period between 16 and 30 June 2016, with Vitol being obliged to nominate a vessel by 27 June 2016 at the latest.

Beta experienced various troubles and notified Vitol that it was going to be unable to perform its obligations under the contract and deliver the biofuel. Through a series of emails and other communications, Beta requested that the contract for delivery of the biofuel be varied or brought to an end, and proposed an alternative arrangement in the form of a 'tolling agreement'.

Ultimately, Beta did not deliver the biofuel. Vitol did not nominate a vessel and, on 7 July 2016, gave notice terminating the contract.

Vitol subsequently brought proceedings against Beta claiming loss of profits. It argued that Beta was in repudiatory and/or renunciatory breach of its contractual obligations by making it clear that it would not perform its contractual obligations, and that Vitol accepted that breach by either not nominating a vessel on 27 June, or alternatively through its notice of contractual termination on 7 July.

However, while accepting that it was in anticipatory breach, Beta argued that Vitol's failure to nominate a vessel did not constitute acceptance of the breach and was a mere oversight. Beta also claimed that Vitol's obligation to nominate a vessel was a condition precedent to the delivery occurring, without which Beta was unable to perform its contractual obligations and deliver the biofuel. Consequently, Beta argued that Vitol's failure to nominate relieved Beta of its obligations under the contract.

Decision

The Commercial Court decided that Vitol's failure to nominate a vessel was not a sufficiently clear and unequivocal act that could amount to its acceptance of Beta's renunciatory/repudiatory breach. In reaching this decision, the Commercial Court considered the ongoing negotiations between the parties at the time, and the absence of an '*express statement of termination*'. Instead, Vitol terminated the contract by its notice dated 7 July 2016.

However, the Commercial Court also rejected Beta's argument that the obligation on Vitol to nominate a vessel was an express condition precedent to the performance of its obligations. In doing so, the Commercial Court rejected the authorities relied upon by Beta (*Armitage v Insole* (1850) 14 QB 728 ('**Armitage**') and *Sutherland v Allhusen* (1866) 14 LT 666 ('**Sutherland**')), both of which found that failure to nominate a vessel relieved the seller of its obligations to deliver. The Commercial Court distinguished those authorities on their facts. Firstly, in *Sutherland*, although the seller's stock had been exhausted, it had not repeatedly informed the buyer of its inability to perform the contract. Second, *Armitage* was distinguished because there was no lifting period in the contract and the seller's duty to deliver only arose on nomination of a vessel by the buyer. Instead, the Commercial Court commented that:

> *'It is relevant to examine the purpose of the condition precedent contended for by Beta. It is to enable performance by the seller under the Contracts. When the parties know that such contractual performance is impossible, as was the case here, the obligation to nominate is simply stripped of its purpose and otiose. Without an assumed ability to perform, there is no rationale for the existence of a condition precedent. On the facts of this case, where to both parties' knowledge, the Contracts could not and would not be performed by Beta, the condition precedent contended for does not thus arise on a proper construction of the Contracts.'*

Accordingly, in circumstances where Vitol was ready and willing to nominate, and Beta had indicated it could not deliver, Vitol had properly 'terminated' the contract and was entitled to damages.

Comment

In these difficult times for many oil and gas companies, it is not uncommon for a buyer of oil or other fuels to be faced with circumstances in which a seller indicates it is unable to perform its obligations to deliver under a contract. The buyer will then be required to consider whether it is able to claim contractual termination and/or to accept the seller's conduct as bringing the contract to an end as renunciatory/repudiatory breach and/or affirm the contract.

In the interim, while the buyer considers its options, it is apparent from the decision of the Commercial Court, that it is possible that an intervening failure of a buyer to nominate a vessel, when contractually required to do so, might have the impact of relieving the seller of its obligations to deliver. If so, this might mean that the seller would not be in breach for a failure to deliver and prevent the buyer from terminating the contract and/or accepting the seller's conduct as bringing the contract to an end as renunciatory/repudiatory breach. In these circumstances, the buyer would be left with no cargo and no damages for the seller's admitted inability to perform.

Whether any given circumstance does mean that a buyer's obligation to nominate a vessel is a condition to the seller's performance, creating the situation above, will turn on the terms of the contract in question and each factual circumstance.

The decision of the Commercial Court is doubtless controversial as it departs from other authorities. However, it does emphasise the need for an 'innocent party' that is subject to a counterparty's refusal to perform to carefully consider its own position and obligations speedily, reserving its rights in the interim, so as to ensure that any right is not lost.

Judge: Carr J.

Drilling units, FPSOs, tankers and support vessels

The supply chain continues to be severely disrupted by lower than projected oil prices. Existing contracts concerning drilling units, FPSOs, tankers and support vessels have all come under pressure – with issues of termination, renegotiation and exercise of options playing a significant role.

- In *Teekay Tankers Ltd v STX Offshore Ltd* [2017] EWHC 253 (Comm), the Commercial Court was asked to consider whether an 'option' for the construction of crude oil tankers was void for uncertainty due to the option not including a delivery date.
- In relation to remedies concerning termination for non-payment, the Court of Appeal in *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2016] EWCA Civ 982 was asked to decide whether common law damages were payable.
- The Supreme Court delivered its decision in the long-awaited '*New Flamenco*' judgment - *Globalia Business Travel S.A.U. (formerly TravelPlan S.A.U.) of Spain v Fulton Shipping Inc of Panama* [2017] UKSC 43 – giving important guidance as to the relationship between an innocent party's actions post-breach and its right to full damages.
- In *ICBC Financial Leasing Co Ltd v Consultants Group Commercial Funding Corporation (trading as CG Commercial Finance)* [2016] EWHC 1683 (Comm), the Commercial Court highlighted the importance of clear drafting of 'non-circumvention' provisions.

Left with no 'option' despite 'best efforts'

In *Teekay Tankers Ltd v STX Offshore Ltd* [2017] EWHC 253 (Comm) the Commercial Court decided that an option agreement for the construction of crude oil tankers was void, as the option agreement required the parties to mutually agree a delivery date at a time in the future. In doing so, the Commercial Court illustrated the risk of seeking to leave key elements of an agreement to be '*mutually agreed*' at a later point in time.

Background

Teekay Tankers Ltd ('**TT**') and STX Offshore Ltd ('**STX**') entered into four shipbuilding contracts for crude oil tankers (the '**Firm Contracts**'), each concerning one firm vessel, and one option agreement whereby STX agreed to grant TT options to build three additional sets of up to four vessels. Prior to the agreements being signed, TT discovered that STX was in talks with creditors to restructure its debt; nonetheless, TT signed the agreements on 5 April 2013.

A key condition of each of the Firm Contracts was the provision of a refund guarantee as security for TT's advance instalment payments. These guarantees were each due to be provided by STX's banks in favour of TT within 30 banking days following the firm contract execution. In the event of a failure to provide a refund guarantee within the agreed timescale, TT was '*entitled to rescind*' the firm contract with immediate effect.

In addition, the option agreement required:

> '***Delivery:***
>
> *[4.1] The Delivery Dates for each [of the] Optional Vessels shall be mutually agreed upon at the time of declaration of the relevant option,*
>
> *[4.2] but [STX] will make best efforts to have a delivery within 2016 for each [of the] First Optional Vessels, within 2017 for each [of the] Second Optional Vessels and within 2017 for each [of the] Third Optional Vessels'.*

STX was in talks with its creditors to restructure its debts and the banks refused to provide the refund guarantees. TT brought successful arbitration proceedings against STX for the repudiation of the Firm Contracts and was awarded US$8,110,000 by way of damages. Despite this default under the Firm Contracts, TT chose to exercise its option under the option agreement for the first and second sets of option vessels. TT requested that STX fulfil all contractual terms including to provide shipbuilding contracts for the first and second sets of option vessels within 10 days.

However, STX argued that the option agreement was void for uncertainty due to an essential term (delivery dates) requiring that it was to be '*mutually agreed*' by the parties.

TT argued that:

- a failure by STX to propose delivery dates pursuant to the best efforts obligation, coupled with the assertion that STX would be unable to procure the refund guarantees constituted '*the clearest evidence that [STX] have no intention of honouring their obligations under the Option Agreement*';
- the parties could not have intended that they should remain free to agree or disagree about delivery dates in their own interest, since that would mean that there was simply no obligation; and
- the option agreement could be made certain by:
  - an implied term that, failing agreement, the delivery date would be such date as STX offered, having used its best efforts, within 2016 or 2017 or the earliest date thereafter; or, in the alternative,
  - an implied term that the delivery date would be an objectively reasonable date determined by the Court having regard to STX's obligation to use its best efforts to provide delivery dates within 2016 or 2017.

Decision

The Commercial Court observed that TT did not dispute that the identification of delivery dates for the relevant vessels was an essential element of the contract. Absent an essential term, a contract will be void for uncertainty. The effect was that TT had to show that the Court could treat the parties as having intended that if an agreement were not reached on delivery dates, then a method would be adopted under which they would be determined. If TT could not show this, then its claim would fail.

The Commercial Court explained:

> *'It is sometimes the case that if parties have not reached agreement on a significant part or parts of their contract, it may be that their intention is that there should be no binding relationship until the remaining part or parts have been agreed'.*

TT argued that this was not the case here. The Commercial Court noted that TT could be said to be, '*pushing at an open door*', and agreed with TT that the parties intended that the option agreement would be legally binding.

However, that was not a complete answer to the question of uncertainty.

Law: Agreements to agree
The Commercial Court sought to apply Rix LJ's principles concerning the enforceability of 'agreements to agree' in *Mamidoil-Jetoil Greek Petroleum Co SA v Okta Crude Oil Refinery AD* [2001] 2 Lloyd's Rep 76 and Chadwick LJ's principles concerning the enforceability of 'agreements to agree' in *B J Aviation Ltd v Pool Aviation Ltd* [2002] 2 P & CR 25, which was the approach approved by the Court of Appeal in *MRI Trading AG v Erdenet Mining Corp LLC* [2013] EWCA Civ 156.

Amongst other things, these principles include:

- Each case must be decided on its own facts and on the construction of the words used in the particular agreement.
- If on the true construction of the words the parties must be taken to have intended to leave some essential matter to be agreed between them in the future – on the basis that either will remain free to agree or disagree about that matter – there is no bargain which the courts can enforce.
- Where the court is satisfied that the parties intended that their bargain should be enforceable, it will strive to give effect to that intention. In order to achieve that result the court may feel able to imply a term. However, the court cannot imply a term which is inconsistent with what the parties have actually agreed.
- If, on the true construction of the words, the court is driven to the conclusion that they must be taken to have intended that the matter should be left to their future agreement on the basis that either is to remain free to agree or disagree about that matter as his own perceived interest dictates, there is no place for an implied term.

Application to option agreement
The Commercial Court decided:

- A specific delivery date was integral to the operation of other important parts of the shipbuilding contract – such as operation of the delay, cancellation and liquidated damages provisions of the contract.
- Where parties have failed to specify a time for performance, the Court will often have little difficulty in implying a term that performance must take place within a reasonable time. However, the considerations which arise in that regard are very different from the considerations which arise in a case where a precise date has to be specified.
- In seeking to identify the true intention of the parties, the Court in the present case had to ask, '*If their true intention was that the delivery date would be identified by determining what is reasonable, why did the parties state expressly in Clause 4 that STX would 'make best efforts' to identify a delivery date within the relevant year?*'. There was no satisfactory answer to that question. What was said about '*best efforts*' seemed to implicitly recognise that the contrasting interests of the parties precluded the identification of a delivery date on the basis of what would be '*reasonable*'.
- It was well established that there is a crucial distinction between agreeing to use best efforts or best endeavours to achieve a particular result, and agreeing to use best efforts or best endeavours to reach agreement upon an essential term in a contract.
- There was no basis for thinking that Clause 4 required one party or the other to provide the initial proposal. If TT did not seek a delivery date within the relevant year, then there would be no need for STX to consider whether it could offer a delivery date within that year. If, however, TT sought a date within the relevant year, then Clause 4 contemplated that STX would use best efforts at least to provide a date within the year, if not the date which TT sought. However, TT remained free, in its own interests, to reject any date provided by STX. In this regard, the reference to the use of '*best efforts*' was plainly part of a process of seeking to agree upon an essential term. It was very different from valid and enforceable obligations to use best efforts to achieve a result.

As such, the terms of the option agreement were not consistent with the alleged implied terms. A term could not be implied. The option agreement therefore failed for lack of certainty.

Comment

In *RTS Flexible Systems v Molkerei Alois Muller* [2010] UKSC 14 the Supreme Court confirmed that for a valid contract to come into existence (i) the parties must have intended, objectively ascertained, to create legal relations, and (ii) '*agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations*'.

Where there is an intention to create legal relations, the Courts have traditionally sought to use the tools available to it, such as implied terms, to ensure any apparent absence of essential terms is negated. It might do this in a number of ways. In *Petromec Inc Petro-Deep Societa Armamento Navi Appoggio SpA v Petroleo Brasileiro SA* [2005] EWCA Civ 891 Longmore LJ observed that:

> *'It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered. I have already observed that it is of comparatively narrow scope. To decide that it has 'no legal content' to use Lord Ackner's phrase [in Walford v. Miles] would be for the law deliberately to defeat the reasonable expectations of honest men…'*

It was perhaps for this reason that the Commercial Court noted that TT could be said to be '*pushing at an open door*'.

That said, the Courts have consistently proven unwilling to take steps to negate the absence of an essential term by implying a term, where such an implied term would be inconsistent with the express terms of the parties' bargain.

The decision in *Teekay Tankers Ltd v STX Offshore Ltd* is thus a useful reminder that where the parties have deliberately reserved to themselves a requirement to agree an essential term at a later date ('agreement to agree'), without any objective criteria that the parties are required to achieve when finalising such agreement, or mechanism to resolve a failure to agree, the Courts will likely find that any attempt to imply a term to 'save the agreement' would be inconsistent with the express terms of the contract that the parties are to agree such term between themselves. As such, if the missing term is essential, the contract will be void for uncertainty.

In the oil and gas industry, it is common that long-term agreements necessarily leave aspects, sometimes essential aspects, to be resolved (or renegotiated) at a later date. Parties would be well advised to be aware of the following:

— If parties wish to ensure a contract comes into existence, notwithstanding an 'agreement to agree' concerning a potentially essential term, they should seek to provide an objective criteria through which the essential term may be later defined (e.g. reasonable price) and a mechanism through which any such omission might be resolved (e.g. expert determination or arbitration).

— Conversely, if parties do not provide an objective criteria and/or mechanism for filling the gap, but reserve the issue to be resolved by mutual agreement between themselves, there is a likelihood that, all other things being equal, the court: (i) will be prevented from implying criteria and/or a mechanism to resolve any impasse; and (ii) as a consequence, may decide the agreement lacks certainty and is void.

Judge: Walker J.

Perils of the sea: Court of Appeal clarifies the remedies for termination for non-payment under a time charter

For some time there has been a lack of clarity as to the consequences of termination for a charterer's failure to pay hire punctually under a time charterparty. However, the recent unanimous Court of Appeal decision in *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2016] EWCA Civ 982 has resolved this debate by deciding that compensation to the owner will not automatically be due as punctual payment of hire is generally not a condition of such contracts, unless expressly said to be so.

The Court of Appeal decision has significant consequences for the drafting of payment and termination clauses in charterparties and other contracts that allow termination for non-payment.

Background

In 2010 Spar Shipping leased three vessels to Grand China Shipping (Hong Kong) Co. Ltd under three long-term NYPE 1993 time charters on essentially identical terms. Each of the charterparties contained a withdrawal clause that provided insofar as material as follows:

> *'11. Hire Payment*
>
> *(a) Payment*
>
> *Payment of Hire shall be made so as to be received by the Owners or their designated payee….in United States currency, in funds available to the Owners on the due date, 15 days in advance…..… Failing the punctual and regular payment of the hire, or on any fundamental breach whatsoever of this Charter Party, the Owners shall be at liberty to withdraw the Vessel from the service of the Charterers without prejudice to any claims they (the Owners) may otherwise have on the Charterers.'*

From April 2011 the charterer was in arrears for payment of hire under all the charterparties. Although the charterer promised to pay in due course, in late September 2011 Spar Shipping withdrew the vessels and issued termination notices. Spar Shipping initially commenced arbitration proceedings against the charterer, but shortly before the hearing the charterer went into liquidation. As a result Spar Shipping commenced an action against the parent company guarantor in the Commercial Court for both the balance of historic hire due under the charterparties and for damages for loss of bargain in relation to the unexpired term of the charterparties.

High Court Decision

The judge at first instance, Popplewell J, held that clause 11 of the 1993 NYPE time charters was not a contractual condition. As a consequence, the operation of Clause 11(a) did not entitle the ship owner to payment of anything more than the outstanding historic hire. Popplewell J also held, however, that in this case the facts demonstrated that the charterer had renunciated the charterparties at termination (by in practice refusing to perform its obligations substantially in accordance with the express terms), meaning that the ship owner could additionally be compensated for loss of bargain, in total some US$25 million, plus interest and legal costs. This decision was then appealed.

Court of Appeal Decision

There were two key questions before the Court of Appeal: (i) is it a condition of contract that the charterer must pay hire punctually; and (ii) was the charterer's proposal to pay the hire at some point in future but not in advance a renunciatory breach of contract?

Condition of contract
In relation to whether it was a condition of contract that the charterer must pay hire punctually, the Court of Appeal accepted that there were conflicting High Court decisions and academic commentary.

The Court of Appeal looked in some detail at the different types of terms in a contract; classifying them into the traditionally recognised categories of:

- Conditions – major terms, every breach of which would deprive the innocent party of substantially the whole benefit of the contract and entitle it to terminate and to claim damages;
- Warranties – simple minor terms, the breach of which will not deprive the innocent party of the benefit of the contract; and
- Innominate (or intermediate) terms – more complex obligations for which the remedy for any breach will depend on the nature, consequences and effect of that breach.

Gross LJ summarised '*unless the contract made it clear that a particular stipulation was a condition or only a warranty, it was to be treated as an innominate term; the Courts should not be too ready to interpret contractual clauses as conditions*'.

The Court of Appeal concluded that, in the absence of express wording in the Spar Shipping time charters, the obligation to pay hire on time was not a condition of the contract, but only an innominate term. The Court of Appeal weighed up the competing case law and concluded that notwithstanding the importance of the timely payment of hire, it could not be said that any failure to pay hire punctually in advance, no matter how trivial, would derail Spar's performance under the charterparties. It was also telling that the NYPE standard form, or other industry standard forms, did not make it clear that payment of hire was a condition. The Court of Appeal's decision meant that in relation to the first question whilst Spar Shipping could exercise an option to withdraw the vessel, it would only be entitled to claim hire up to termination and could not claim for the hire which should have become due for the remaining term of the three charterparties.

Renunciatory breach
However the Court of Appeal then went on to look at the second question. The Court of Appeal noted that there are a variety of different formulations of the test for renunciation given the need to apply the test in the widest range of factual circumstances. Gross LJ summarised:

> *'…it is important to keep in mind that a renunciation is not confined to an evinced unwillingness to perform the contract at all; an evinced unwillingness to perform the contract according to its terms (whether through inability or otherwise) may likewise amount to a renunciation if the performance proffered is substantially inconsistent with that party's obligations thereunder… Further, renunciation may be inferred where it is apparent that the defaulting party is doing no more than procrastinating in the hope that something may turn up…'.*

The Court of Appeal highlighted three key questions to be answered when considering whether renunciation had occurred: (i) what was the benefit the innocent party was intended to obtain from the contract; (ii) was the prospective non-performance foreshadowed by the words and conduct of the breaching party; and (iii) was the prospective non-performance such as to go to the root of the contract?

The Court of Appeal found in this case there was no room for doubt; Spar Shipping could have '*no realistic expectation*' that the charterer would in future pay hire punctually in advance and the judge at first instance could conclude that the charterer had renounced the charterparties at the dates of the termination notices. This meant, although the Court of Appeal decided that there had not been a breach of an express contractual condition, Spar Shipping was entitled to compensation for its loss of bargain as a result of the charterer's common law renunciation of the contract.

Comment

It remains the approach of English law that termination for breach of a condition under the express termination terms of a contract will be treated the same as termination at common law. It follows that termination for breach of a condition will attract common law damages, unless the contract stipulates otherwise.

The Court of Appeal's judgment has a number of important consequences for drafters of charterparties and similar contracts:

— Although this decision brings some clarity to the historic conflicting judicial statements on the consequences of withdrawal of a vessel upon failure to pay hire punctually, ship owners entering into charters providing for withdrawal of a vessel on non-payment of hire may now be less able to recover losses unless there is specific contractual provision allowing such claims.

— The NYPE standard form has been amended in the 2015 version to improve the position on recovery, but other standard forms (such as BIMCO) have not yet followed suit.

— It may be sensible, therefore, for ship owners to take the opportunity now to review their charters to ensure, where relevant, these provide expressly that:

  - Punctual payment of hire is a condition of the contract;
  - Time is of the essence for payments due under the contract; and/or
  - If they elect to withdraw the vessel because of failure to make punctual payment of hire, they shall also be entitled to damages for the loss of hire rates for the remainder of the contract.

The effectiveness of such drafting additions is still likely in practice to depend on the facts and circumstances of each case.

Finally, it is of some interest that the High Court and Court of Appeal decided that the charterers' repeated failure to pay amounted to a renunciation of the charterparty. Whilst such findings are fact specific and therefore might not be of general application, the decision seems to be based on the proposition that it is a fundamental aspect of a charterparty that the hire is paid in advance. Where a charterer makes it clear it cannot pay in advance, or it is obvious from the factual records that it cannot do so, it effectively renounces its ability to perform the contract in substantially the same manner as agreed. This might occur by words or conduct in many circumstances where the charterer has solvency issues. It means that charterers should be extremely careful in how they conduct their communications with owners in the event of financial difficulties. It may also make it difficult for financially distressed charterers unable to make repeated payments to avoid a claim for renunciation upon a withdrawal of the vessel for non-payment.

Judges: Sir Terence Etherton, Gross LJ, Hamblen LJ.

The New Flamenco: Post breach mitigation

The Supreme Court, on 28 June 2017, found in favour of the owners in the long-awaited '*New Flamenco*' judgment - *Globalia Business Travel S.A.U. (formerly TravelPlan S.A.U.) of Spain v Fulton Shipping Inc of Panama* [2017] UKSC 43.

The decision of the Supreme Court gives important guidance as to the relationship between an innocent party's actions post-breach and its right to full damages.

Facts

In brief, the facts are:

— the New Flamenco was a cruise ship owned by Fulton Shipping Inc and time chartered to Globalia Business Travel S.A.U.;

— the time charter commenced in 2004, was extended more than once, and in 2007 the charterer redelivered the vessel in repudiation of a two-year extension which was about to start; and

— the owner sold the vessel in October 2007 for US$23,765,000 million.

The owner advanced its claim for damages calculated by reference to the net loss of profits which they alleged that it would have earned during the additional two-year extension. The amount claimed was EUR€7,558,375.

The charterer argued that the owner was bound to bring into account and give credit for the whole difference between the amount for which the vessel had been sold in October 2007 (US$23,765,000) and her value in November 2009 (subsequently found by the arbitrator to be US$7,000,000). The owner argued that the difference in value was legally irrelevant and did not fall to be taken into account.

The arbitrator found for the charterer, holding that the sale was made in mitigation of the losses caused by the repudiation. That decision was appealed on a point of law under Section 69 of the Arbitration Act 1996 and Popplewell J allowed the appeal, holding that there must be a direct connection between breach and benefit. Here, the benefit received by the owner was caused by the fall in the shipping market and not by the charterer's breach.

The Court of Appeal reinstated the arbitrator's decision, finding that the benefit did in fact arise as a consequence of the breach. That benefit should therefore be taken into account when determining the claimant's loss.

Decision

The Supreme Court has now indicated a preference for Popplewell J's approach and allowed the appeal. Lord Clarke stated that the fall in the vessel's value was irrelevant because the owner's interest in the capital value of the vessel was unrelated to the injury suffered as a result of the charterer's repudiation. The difference in the value of the vessel was in Lord Clarke's opinion not caused by the repudiation of the charterparty - the owner's decision to sell the vessel in 2007 was purely commercial, had nothing to do with the charterer (and indeed could have happened while the vessel was still on charter), and was made at the owner's own risk. As Popplewell J said, the breach merely provided the context or the occasion for the sale – '*it was the trigger not the cause*'.

Further, the sale of the vessel was not of itself an act of mitigation. In an available market, the loss would have been the difference between the charterparty rate and the assumed substitute contract rate; in the absence of an available market, the alternative rate would be what ought reasonably to have been earned from shorter charters e.g. on the spot market. The relevant mitigation for the loss of the charterparty income stream is the acquisition of an alternative income stream and the sale of the vessel cannot mitigate that loss.

Popplewell J was therefore correct to hold that the arbitrator erred in principle. The charterer is not entitled to a credit of EUR€11.2 million and a number of outstanding issues have been remitted back to the arbitrator for determination.

Comment

Charterers should be mindful of the potential for damages claims when considering whether to retain vessels on charter or terminate early through a repudiatory breach.

The decision of the Supreme Court suggests that the owner's treatment of the vessel, post acceptance of repudiatory breach, might be of limited relevance in calculating damages. In particular, it appears that the sale of the vessel by the owner is unlikely to be a mitigating factor that might be taken into account to reduce damages. The decision is of critical relevance, as mitigation is also a duty on an innocent party. As such, if the decision was different it might have suggested that an owner was under an obligation to sell a vessel to mitigate a loss under a charter (if the sale price would have reduced the loss). This would obviously have created issues of serious concern to owners.

The decision appears to ensure that owners will continue to have a 'free hand' in dealing with the ownership (or sale) of a vessel post acceptance of a repudiatory breach of charter, without impacting the owners' right to the usual measure of damages for such cases. This continues to be the difference between the charter rate for the remaining period of hire less the assumed market rate for such vessel for the remaining period of hire (assuming that an available market exists – and, where it does not, the second figure would be what ought reasonably to have been earned in the short-term market). The calculation of damages, when it comes to the repudiation of charter contracts, remains relatively straightforward and without reference to the rest of an owner's business.

Judges: Lord Neuberger PSC, Lord Mance JSC, Lord Clarke JSC, Lord Sumption JSC, Lord Hodge JSC.

Finance Intermediaries: 'Non-circumvention' provision not applicable

Confidentiality and 'non-circumvention' agreements are widely used by intermediaries in financing and transactions. In *ICBC Financial Leasing Co Ltd v Consultants Group Commercial Funding Corporation (trading as CG Commercial Finance)* [2016] EWHC 1683 (Comm), the Commercial Court highlighted the importance of clear drafting of such agreements when it decided that a party providing finance had not breached a non-circumvention provision by entering into a direct transaction with the party seeking funding.

Facts

In April 2013, Consultants Group Commercial Funding Corporation ('**CGCF**'), a Californian company specialising in the provision or arranging of finance for 'big ticket' capital equipment, was mandated by Golar LNG Ltd

('**Golar**'), one of the leading owners and operators of Liquefied Natural Gas ('**LNG**') owner operator carriers, to arrange financing for the first of thirteen vessels on order from two Korean shipyards (the '**Mandate**'). These vessels comprised eleven LNG carriers and two Floating Storage and Regasification Units ('**FSRUs**').

In turn, CGCF approached ICBC Financial Leasing Co Ltd ('**ICBCL**'), which is the financial leasing subsidiary of the Industrial and Commercial Bank of China, as a potential provider of finance. So as to allow CGCF to pass certain confidential information to ICBCL and protect CGCF's position as financial arranger, CGCF and ICBCL executed a confidentiality letter (the '**Confidentiality Letter**').

The Confidentiality Letter contained confidentiality and non-circumvention provisions that required:

> ***Clause A3***
>
> *'ICBCL and its Representatives all agree (i) to hold Confidential Information of the Company and/or Customer in confidence, (ii) not to disclose Confidential Information to any third party, except as specifically authorized herein or as specifically authorized by the Company in writing, (iii) not to use any Confidential Information for any purpose other than in connection with participating with the Company in the Financing, and (iv) not to circumvent the Company with respect to the Financing'.*

'*Financing*' was defined as '*one or more possible loan or lease financings … for Company's customers and subsidiaries and affiliates (each of which will be referred to hereinafter separately as the '**Customer**')*'.

'*Confidential Information*' was widely defined, but the Confidentiality Letter made clear that the definition did not extend to information which '*at the time of disclosure or thereafter is in the public domain or generally known by the public (other than as a result of its disclosure by ICBCL … in violation of this Agreement)*' or which is already known to ICBCL prior to disclosure by CGCF.

When CGCF failed to provide Golar with a funding offer, Golar decided to fund the first eight vessels through Korean export credit banks and told CGCF to stop work. CGCF hoped for a role providing finance for subsequent vessels and continued to press ICBCL for terms. However, CGCF did not inform ICBCL that the Mandate had expired or that Golar had obtained funding elsewhere.

In August 2013, ICBCL provided offer terms, subject to CGCF obtaining an exclusive mandate from Golar. CGCF did not present the offer terms to Golar and discussions between CGCF and ICBCL eventually ceased.

In October 2013 ICBCL was separately approached (not by CGCF) in relation to five later vessels in Golar's newbuilding schedule, which led to signature of a term sheet in November 2013 in respect of four of those vessels (the '**November Transaction**').

CGCF contended that ICBCL was in breach of the Confidentiality Letter in four respects, including amongst other things, that by entering into the November Transaction ICBCL '*circumvented*' it with respect to a '*Financing*' in breach of clause A3(iv).

Decision

The Commercial Court decided that ICBCL was not in breach of the Confidentiality Letter.

ICBCL contended that on a fair reading of the agreement as a whole, the obligation in clause A3(iv) was to not circumvent CGCF by misusing Confidential Information. Thus circumvention was permitted, or at any rate was not prohibited by clause A3(iv), provided that it did not use Confidential Information provided by CGCF.

The Commercial Court agreed. Notwithstanding the fact that clause A3(iv) did not use the words '*Confidential Information*', a fair reading of the agreement as a whole led to the conclusion that the obligation in clause A3(iv) was '*not to circumvent CGCF by misusing Confidential Information*' rather than a stand-alone general obligation not to circumvent CGCF regardless of such misuse.

The Commercial Court accepted that CGCF had a legitimate interest in protecting its business connections and ensuring that it was not cut out of any deal. But that interest should not be taken too far. If the identity of the Customer or the fact that it is looking for finance is not generally known and only comes to ICBCL's attention as a result of disclosure by CGCF, a direct approach by ICBCL to the Customer cutting out CGCF would involve a misuse of Confidential Information and will fall foul of the clause.

However, if the fact that a shipowner is looking for finance is widely known in the market and there is nothing special or distinctive about its requirements, there is no necessary commercial reason why ICBCL should not deal with that shipowner without CGCF, at any rate if (as in the present case) it is the recipient of an entirely separate approach authorised by the Customer through another intermediary. The Commercial Court considered there was no valid reason to approach the construction of the Confidentiality Letter with a predisposition to find that it prevented ICBCL from doing so in such circumstances.

As the Commercial Court found, as a matter of fact, that ICBCL had not misused Confidential Information in entering into its financing transaction there could be no breach of the non-circumvention provision in clause A3(iv) of the Confidentiality Letter.

The Commercial Court also found that there were further reasons for ICBCL not being in breach. Although '*Customer*' and '*Financing*' were not carefully defined in the Confidentiality Letter:

— Golar was not a '*Customer*' as required by the relevant clause of CGCF at the relevant time, as Golar ceased to be a '*Customer*' of CGCF when CGCF was told by Golar to stop work.

— The transaction undertaken by ICBCL was not covered by the meaning of '*Financing*' within the Confidentiality Letter, as the 'Financing' which the parties discussed did not extend to the financing either of the Golar newbuilding programme as a whole or of any of the four 2014 vessels which became the subject of the November transaction.

As a consequence CGCF's claim for '*circumvention*' failed. In the words of the Commercial Court circumvention '*involves an element of going around or avoiding an obstacle of some sort. If there is no obstacle to be avoided, it is hard to see that any question of circumvention could arise. That is the straightforward position which applied here. The November Transaction was entirely independent of any discussions which had taken place with CGCF*'.

Comment

Confidentiality and 'non-circumvention' agreements are widely used by intermediaries in financing and M&A transactions. It is critical that parties to such agreement properly draft and understand the scope of the obligations contained in such agreements.

In the context of global financial and M&A transactions, information concerning 'opportunities' for transactions may be gained from numerous sources. Some of these may be public sources; others may be confidential. In seeking to agree a 'non-circumvention' provision parties should consider what it is that the party receiving information is disentitled to 'circumvent'. The scope of the restriction should then be clearly drafted into the agreement to seek to avoid future disputes.

In drafting any restriction, it is important for intermediaries relying on such clauses to ensure that the scope of any restriction is legitimate in relation to the confidential information or interest that it seeks to protect. A provision that seeks to entirely prevent a transaction taking place absent the involvement of the intermediary, even where there is no legitimate interest of the intermediary to protect, might well be void as a restraint of trade.

Judge: Males J.

Mergers and Acquisitions

Whilst the M&A market has remained challenging over the past twelve months, the English Courts have continued to deal with issues that are of direct relevance to those negotiating and drafting oil and gas M&A deals.

— Deferred consideration is an increasingly common aspect of oil and gas M&A transactions. In *Astor Management AG & Anor v Atalaya Mining Plc & Ors* [2017] EWHC 425 (Comm), the Commercial Court considered whether the wording of a trigger event for deferred consideration meant consideration was not due.

— In *Wood v Capita Insurance Services Limited* [2017] UKSC 24, the Supreme Court refused to give a wider interpretation to an indemnity where narrower warranties existed in the sale and purchase agreement.

— In *Abbot Investments (North Africa) Ltd v Nestoil Ltd* [2017] EWHC 119 (Comm) a dispute arose concerning alleged representations relating to an oil rig owned by the target company that were said to allow the entire deal to be rescinded.

Deferred consideration not due

In *Astor Management AG & Anor v Atalaya Mining Plc & Ors* [2017] EWHC 425 (Comm), the Commercial Court considered whether the payment of deferred consideration was due in an M&A transaction. Alternatively, whether the buyer had failed to use its required '*all reasonable endeavours*' to achieve a condition to making the deferred consideration payable. The Commercial Court found that the deferred consideration was not due and there had been no breach of the '*all reasonable endeavours*' obligation, even though the commercial purpose underlying the deferral of the consideration seemed to have been achieved. The dispute arose between participants to a copper ore mining project, but its lessons are relevant to M&A transactions in the oil and gas industry.

Facts

Astor Management AG ('**Astor**') and Atalaya Mining Plc ('**Atalaya**') entered into an agreement in September 2008 relating to the ownership and exploitation of copper ore at a mining project in southern Spain (the '**Master Agreement**'). Under the terms of the Master Agreement, Atalaya acquired Astor's minority interest in the mining project for EUR€63 million; the majority interest being owned by another company in Atalaya's group. The copper mine was dormant at the time the parties entered into the Master Agreement but was potentially very valuable, with 123 million tonnes of proven and probable reserves.

As Atalaya would not have sufficient resources to buy out Astor's remaining interest until such time as mining restarted, payment of the consideration was mostly deferred and payable by Atalaya in three tranches on the occurrence of certain trigger events:

- **First payment:**
  - within 30 business days of the date on which:
    - the regional government granted permits for the restart of mining activities;
    - Atalaya secured senior debt finance for a sum sufficient for the restart of mining operations at the project ('**Senior Debt Facility**'); and
    - Atalaya could effectively draw down on the Senior Debt Facility.
- **Second payment:** within 20 business days of the first anniversary of the restart of mining activities.
- **Third payment:** within 20 business days of the second anniversary of the restart of mining activities.

Atalaya undertook to use '*all reasonable endeavours*' to obtain the Senior Debt Facility and to procure the restart of mining activities at the project on or before 31 December 2010 (the '**Target Date**').

Atalaya ultimately failed to secure the Senior Debt Facility by the Target Date; although by June 2015 it had instead raised finance through equity and intra-group loans. The permits necessary for the restart of mining activities were issued in July 2015 and mining re-commenced before the end of that month.

Astor advanced the claim before the Commercial Court that payment of the deferred consideration was triggered on the restart of mining activities in July 2015. Astor made the primary case that, when the mining operations were restarted without the need for a Senior Debt Facility, the requirement to obtain such a facility fell away (it being '*futile*') and the obligation was triggered by the grant of the permits alone. In the alternative, Astor contended that the finance secured to restart mining operations constituted '*senior debt finance*' within the meaning of that term in the Master Agreement.

Also, alternatively, Astor argued that if the deferred consideration was not triggered, this was because Atalaya was in breach of its obligation to use '*all reasonable endeavours*' to secure the Senior Debt Facility. Atalaya argued that payment of the deferred consideration had not been triggered and, given the events that unfolded, it never would be triggered. Atalaya contended that the first tranche was not payable until such time as a Senior Debt Facility was obtained; no such facility was obtained by Atalaya, and the finance raised to restart mining operations did not constitute '*senior debt finance*' within the meaning of the Master Agreement. Further, it had satisfied its '*all reasonable endeavours*' obligation.

Decision

The Commercial Court rejected Astor's argument that, as Atalaya's obligation to secure a Senior Debt Facility had fallen away, the obligation to pay the deferred consideration had been triggered. The Commercial Court made clear that there is no legal doctrine that a precondition need not be satisfied where such satisfaction would be '*futile*', even in circumstances where such a precondition did not serve any useful purpose. It was decided:

'Whether a contractual obligation has arisen in any given case in principle depends on what the particular contract says, interpreted in accordance with the ordinary rules of contract interpretation. There is, in my opinion, no principle of law or even interpretive presumption which enables a contractual precondition to the accrual of a right or obligation to be disapplied just because complying with it is considered by the Court to serve no useful purpose.'

The Commercial Court similarly rejected Astor's claim that the finance raised by Atalaya constituted a Senior Debt Facility, noting that '*senior debt finance*' contemplated finance obtained from outside of Atalaya's company group and would rank in priority to an unsecured intra-group loan.

In relation to whether the requirement for Atalaya to use '*all reasonable endeavours*' to obtain a Senior Debt Facility was a legally enforceable obligation, the Commercial Court decided that it should '*almost always be possible*' to give sensible content to an undertaking to use reasonable endeavours to enter into an agreement with a third party and that:

'Where the parties have adopted a test of 'reasonableness' […] it seems to me that they are deliberately inviting the Court to make a value judgment which sets a limit to their freedom of action.'

It followed that the provision was enforceable. The content of '*all reasonable endeavours*' would depend upon the nature and terms of the transaction in question. In this case, it would not have required the Senior Debt Facility to be sought if mining was uncommercial.

Astor's case that Atalaya was in breach of the '*all reasonable endeavours*' obligation ultimately boiled down to the contention that the sum of US$95 million it raised through equity and intra-group loans in May/June 2015 could – and would if all reasonable endeavours had been used – have been obtained in the form of a Senior Debt Facility provided by one or more of the shareholders. On the evidence, however, this case was not made out. Of the three main shareholders, Trafigura made it expressly clear at the time when funding was being discussed that it was not prepared to provide finance in a form that would trigger payment of the deferred consideration.

The outcome was that Atalaya avoided paying the deferred consideration, as it had not yet fallen due under the terms of the Master Agreement. Further, it had not breached its obligation to use all reasonable endeavours to trigger the deferred consideration.

Comment

Deferred consideration is a familiar concept in oil and gas M&A transactions. It seems likely that the parties, when negotiating the Master Agreement, envisaged a process under which a specific type of funding would be obtained, and the mining permits put in place, following which mining activities would re-commence. The seller did not anticipate that, should the buyer fail to secure the specific type of funding envisaged, alternative funding might be obtained elsewhere and the mining then recommenced.

It may even be that the reason for the Senior Debt Facility and permits being the trigger for payment of the deferred consideration was that Astor, as seller, wished to ensure that its deferred consideration was extracted from funds paid under the Senior Debt Facility, before the costs of mining activities were incurred and paid out of the Senior Debt Facility.

While the approach taken by the Commercial Court in *Astor* might seem uncommercial, the judge noted that the agreement had '*all the hallmarks of a professionally drafted contract made by sophisticated commercial parties*' and the wording in the deferred consideration clause was '*plainly a deliberate choice*'. It was not for the Court to look behind the terms of the contract and second-guess what the parties might have had in mind at the time of signing.

As a consequence, parties drafting a deferred consideration clause should think carefully about how events might unfold, and the implications for the obligation to pay deferred consideration.

As the Courts move away from a 'commercial' approach to interpreting contracts towards one based more on the natural and ordinary meaning of the words in the contract, M&A practitioners should consider the importance of using clear drafting in constructing deferred consideration clauses and also bear in mind the consequences of events not unfolding as originally anticipated.

Judge: Leggatt J.

Supreme Court rules on scope of indemnity

In *Wood v Capita Insurance Services Limited* [2017] UKSC 24, the Supreme Court was required to decide the scope of an indemnity in an M&A sale and purchase agreement. Although not an oil and gas industry case, the result will have an impact on indemnities on oil and gas M&A deals and potentially also on indemnities more widely.

In approaching the interpretation of the indemnity, the Supreme Court ought to reconcile the approach to contractual construction and interpretation adopted by the Supreme Court in *Rainy Sky v Kookmin Bank* [2011] UKSC 50 ('**Rainy Sky**') and *Arnold v Britton* [2015] UKSC 36 ('**Arnold**') (see 2016 CMS Annual Review, page 54). In doing so it decided that, where there are rival meanings to a clause, consideration of the words of the contract (as a whole) and commercial common sense both have a role to play.

Facts

Mr Andrew Wood (the '**Seller**') entered into a share purchase agreement ('**SPA**') with Capita Insurance Services Limited (the '**Buyer**') for the acquisition of the entire issued share capital of Sureterm Direct Limited (the '**Company**'), a car insurance broker.

An indemnity in the SPA stated:

> *'The Sellers undertake to… indemnify the Buyer… against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service.'*

In addition, the SPA contained specific warranties. Schedule 4 of the SPA contained 30 pages of detailed warranties. In Part 12 of that Schedule, which concerned litigation, disputes and investigations, the Seller warranted that it was not aware of circumstances which were likely to give rise to any investigation or enquiry by any Authority and that no breach of contract, tort, statutory duty or law had been committed for which the Company was or might be liable. Part 14, which was concerned with compliance and regulatory matters, included the following paragraph:

> *'14.1*
>
> *(a) The Company conducts, and has conducted the Business in accordance with the requirements of all Competition Laws and Applicable Financial Services Laws applicable to the business and has not been and is not being investigated for any alleged non-compliance or infringement of such Competition Laws and Applicable Financial Services Laws. …*
>
> *(c) The Company has no reason to believe that any action will be taken against it in relation to any of its current or past activities based on any alleged non-compliance or infringement of any Competition Laws and Applicable Financial Services Laws.'*

Part 14 also contained detailed warranties that the Company had complied with its regulatory obligations and that correspondence between the Company and all Regulatory Authorities had been disclosed, that the Company, its officers and employees had not been subject to any regulatory sanction and that no such sanction was likely or pending; and that the Company had not been subject to a regulatory investigation and, so far as the Sellers were aware, there were no circumstances which could give rise to a visit by any Regulatory Authority.

Clause 8 of the SPA provided for limitations on the Seller's liability in Schedule 5, which in paragraph 1 provided that the aggregate maximum liability of all claims under the SPA (with one exception) would not exceed the purchase price and that the liability of each seller would not exceed his proportionate liability (i.e. 94%, 5% and 1%). That limitation applied to claims under the above indemnity as well as under the warranties. But paragraph 3 of Schedule 5 imposed time limits on the warranties by providing:

> *'3.1 Save in respect of a Warranty Claim or a claim under the Tax Covenant notified in writing to the Sellers prior to such a date, the Sellers will cease to be liable:*
>
> *(a) for any claim under the tax warranties or under the Tax Covenant on the seventh anniversary of Completion; and*
>
> *(b) for any other Warranty Claim on the second anniversary of Completion.'*

Thus in contrast to the indemnity, the warranties relating to, among other things, regulatory compliance, had a lifespan of only two years.

Following conclusion of the deal, the Company's employees raised concerns about potential mis-selling of products to customers in the period prior to the acquisition. The Company conducted a review and reported its findings to the FSA. The FSA concluded that customers had been misled and the Company paid £1.35 million in customer compensation.

The Sellers argued that the Buyer could not rely on the indemnity because it only covered losses which were a result of a '*claim or complaint*' registered with the FSA. As the Company had self-referred to the FSA, the indemnity was not engaged. The Buyer argued that the indemnity set out two categories of losses: '*damages, costs, charges…*' on the one hand and '*fines, compensation, remedial actions, etc.*' on the other. According to the Buyer, only the second category of loss was qualified by the need for the claim to have been registered with the FSA by a customer.

The Buyer succeeded in the High Court, where the Court decided that business common sense required self-reporting to fall within the scope of the indemnity. However, the Court of Appeal decision held that self-reporting was not within the language of the indemnity clause. The Buyer appealed to the Supreme Court, arguing that the Court of Appeal's decision was wrong, because it incorrectly placed too much emphasis on the words of the SPA and gave insufficient weight to the context in which they were agreed (the factual matrix).

Decision

The Supreme Court found in favour of the Sellers and upheld the Court of Appeal decision. Lord Hodge (with whom the other judges agreed) undertook a detailed analysis of the terms of the indemnity in the context of the other contractual terms, and found that its terms (on a close examination) did not cover self-reporting for mis-selling.

Lord Hodge did not accept the Buyer's argument that *Arnold* had altered the guidance given by the Supreme Court in *Rainy Sky*. He gave the following guidance which he considered consistent with *Arnold* and *Rainy Sky*:

- Where there are rival meanings to a clause, the Court can give weight to the implications of rival constructions by reaching a view that is more consistent with business common sense.
- However, in striking the balance between the implications of rival constructions the Court must also consider the quality of the drafting of the clause.

- The Court must be alive to the possibility that a party may have agreed a clause that does not serve its interests.
- It follows that the 'unitary exercise' involves an iterative process whereby rival interpretations are checked against the whole contract and the commercial consequences.
- Once it is established that there are rival interpretations, it does not matter whether this more detailed analysis commences with checking against the whole contract or the factual background and establishing the commercial consequences – so long as the Court balances the indications given by both approaches.
- It may be that the circumstances of the drafting of the contract suggest that more weight should be given to one, or other, of the approaches of checking against the whole contract or the factual background (matrix)/commercial consequences. For example, in the context of a sophisticated contract, checking against the contract might be given more weight.

After a consideration of the detail of the clause, Lord Hodge decided that, had the indemnity stood on its own, the requirement of a claim or complaint by a customer and the exclusion of loss caused by regulatory action which was otherwise prompted might have appeared anomalous. But the indemnity was in addition to wide-ranging warranties which probably covered the circumstances which eventuated. It was not contrary to business common sense for the parties to agree wide-ranging warranties which were subject to a time limit, nor to agree a further indemnity which had no time limit but which was triggered only in limited circumstances. On that basis, the appeal failed.

Comment

The above case serves as a reminder about the relationship between indemnities and the remaining elements of a sale and purchase agreement. Indemnities might be fiercely negotiated in the course of a deal, resulting in a compromise over wording that might not reflect the ideal outcome for buyer or seller. If the words of the indemnity are capable of more than one meaning, English law will use all of the tools available to it to establish its true meaning. In doing so, it will look to other elements of the agreement to aid it with the construction and interpretation of the indemnity.

As warranties and indemnities might overlap, a common sense starting point choosing between rival meanings of an indemnity will be to look to the warranty provisions of the sale and purchase agreement for assistance. As a consequence, drafters should carefully consider how detailed warranty clauses might impact the interpretation of an indemnity.

In addition to the specifics of the decision, the case seeks to give some guidance on the general approach to contract interpretation. In a series of decisions culminating in the Supreme Court's decision in *Rainy Sky*, the Court decided that, if there are two possible ways of reading a contract, the reading which is consistent with commercial common sense can be preferred. Following *Rainy Sky*, parties routinely argued commercial common sense in support of their construction of disputed terms in contracts.

Some commentators queried whether such an approach was still relevant after *Arnold*, which appeared to place an emphasis on the natural and ordinary meaning of the words of the contract and cautioned against using 'business sense' to relieve a party of a bad bargain.

Lord Hodge's comments seek to clarify the '*misconception*' that *Arnold* '*rowed back*' on the role of business common sense in the interpretation of contracts. In the words of Lord Hodge '*I do not accept the proposition that Arnold involved a recalibration of the approach summarised in Rainy Sky*'. The approach in *Wood* suggests that where there are rival meanings to a clause, the Supreme Court seems to have identified that the law permits a variety of methods to arrive at the correct answer. The correct approach will likely depend upon the circumstances of the case. In some cases, a textual approach to the contract will be more useful. In others, the context and business sense will more likely yield the answer. However, hindsight is not part of the exercise.

Although *Wood* suggests that it seems likely that the Courts will place more emphasis on the words of the contract where it has been professionally drafted, Lord Hodge recognised that negotiators of complex and formal contracts might not achieve a logical and coherent text because of factors such as the challenges of the negotiation process and the conflicting interests of the parties. Therefore, even where a contract has been professionally drafted and heavily negotiated, its commercial context must not be ignored, and the commercial context may be particularly helpful in interpreting the contract.

Notwithstanding the above, the final word on Wood might go to Lord Sumption. Whilst Lord Hodge delivered a unanimous decision of the Supreme Court, Lord Sumption has made some extra-judicial comments that suggests that he might not entirely agree that Arnold was not a 'recalibration' of Rainy Sky. At the Harris Society Annual Lecture, at Keble College Oxford, on 8 May 2017, Lord Sumption expressed the view that:

> *'Just as [Investors Compensation Scheme v. West Bromwich Building Society [1997] UKHL 28] changed the judicial mood about language and tended to encourage the view that it was basically unimportant, so more recent cases may in due course be seen to have changed it back again, at least to some degree. Experience has suggested that the loose approach to the construction of commercial documents which reached its highest point in Rainy Sky may have done a disservice to commercial parties by depriving them of the only effective means of making their intentions known.'*

The natural and ordinary meaning of Lord Sumption's text seems to suggest a '*recalibration*'.

Judges: Lord Neuberger PSC, Lord Mance JSC, Lord Clarke JSC, Lord Sumption JSC, Lord Hodge JSC.

M&A Loan Note Guarantee – establishing discharge by misrepresentation

In *Abbot Investments (North Africa) Ltd v Nestoil Ltd* [2017] EWHC 119 (Comm), a dispute arose concerning alleged representations relating to an oil rig owned by the target company prior to the sale of that target company to a new owner. A party guaranteeing the funding of the purchase refused to make payment under the guarantee due to an alleged misrepresentation concerning oil rig liabilities.

Although the decision of the Commercial Court is short, it provides a useful reminder on the importance of dealing with all issues concerning 'outstanding' liabilities at the time of sale and the difficulties of establishing the existence of representations that are not contained in the sale and purchase agreement.

Facts

On 15 August 2014 Abbot Investments (North Africa) Limited ('**AIL**') sold a company, KCA Tender Barges Pte. Limited ('**KCA**'), to Momentum Far East Pte. Limited ('**Momentum**'), by way of a sale and purchase agreement dated 15 August 2014 ('**SPA**').

It is alleged that prior to execution of the SPA, AIL, as seller, was said to have represented to Momentum, as buyer, that it would pay all expenses and discharge all liabilities in respect of an oil rig owned by KCA, but which did not form part of the sale.

The funding of the purchase under the SPA was provided by a group of companies, which included Nestoil Limited ('**Nestoil**'). The funding included a loan note provided by Momentum Far East Pte. Limited in the sum of US$2 million plus interest for a period of 12 months. Nestoil guaranteed payment of the loan note pursuant to the terms of a guarantee dated 4 November 2014 ('**Guarantee**').

The sale was completed on 20 October 2015. Following completion, Momentum assigned its rights under the SPA to a third party, Scorpio Mauritius. Subsequently:

- The loan note was not repaid when due.
- As a consequence, AIL initiated a claim against Nestoil under the Guarantee.
- Scorpio Mauritius purported to rescind the SPA for fraudulent misrepresentation on the basis that the representations made concerning the rig were false because, at completion, KCA in fact had over US$400,000 of liabilities in respect of the oil rig.
- Momentum also purported to rescind the loan note.

Nestoil contended that the effect of these rescissions was to discharge it from liability under the Guarantee. However, AIL claimed that Nestoil had no reasonable prospect of establishing either the alleged fraudulent misrepresentation or the right to rescind the loan note. AIL contended:

- The misrepresentation claim had no prospect of success.
- If the misrepresentations were made, there was no evidence they were made fraudulently.
- There was no real prospect of Nestoil establishing an effective rescission because the common law remedy of rescission was not available where the SPA had been affirmed and where restitution was not possible. The SPA had been affirmed by Scorpio Mauritius continuing to act as owner of the company and to demand payment pursuant to the contract which they say has been rescinded.
- It also argued that restitution was impossible because the vessels had been used and could not be returned in the same condition in which they had been transferred pursuant to the SPA.

Nestoil, however, contended that if fraud were established then, as a matter of construction of the Guarantee, it could not be obliged to indemnify AIL in respect of a liability arising out its fraud.

Decision

The Commercial Court, though it considered Nestoil's defence to be weak, dismissed AIL's application for summary judgment.

As to the misrepresentation point, the Commercial Court noted that, at the date of the summary judgment application, there was no witness statement on behalf of AIL denying that the alleged misrepresentations were made. Whilst it found that the points raised by AIL were '*powerful points to put… in cross-examination*' of the relevant Momentum witness and that Nestoil's defence was '*particularly weak and very vulnerable to attack*', the Commercial Court was unable to decide on an application for summary judgment that the misrepresentation case had no real prospect of success. For example, the Commercial Court noted that it was possible that the relevant witness might, under cross-examination, provide an explanation as to why he did not mention the alleged misrepresentation when the invoices first came to light.

As to the recession point, the Commercial Court agreed with Nestoil that there was a real prospect that the Guarantee would not be construed as applying if a fraud was established.

However, the Commercial Court required that Nestoil make a payment into Court of US$2 million if it wished to defend the action.

Comment

The decision of the Commercial Court sets out a limited factual background, as it was merely a decision concerning a summary judgment application.

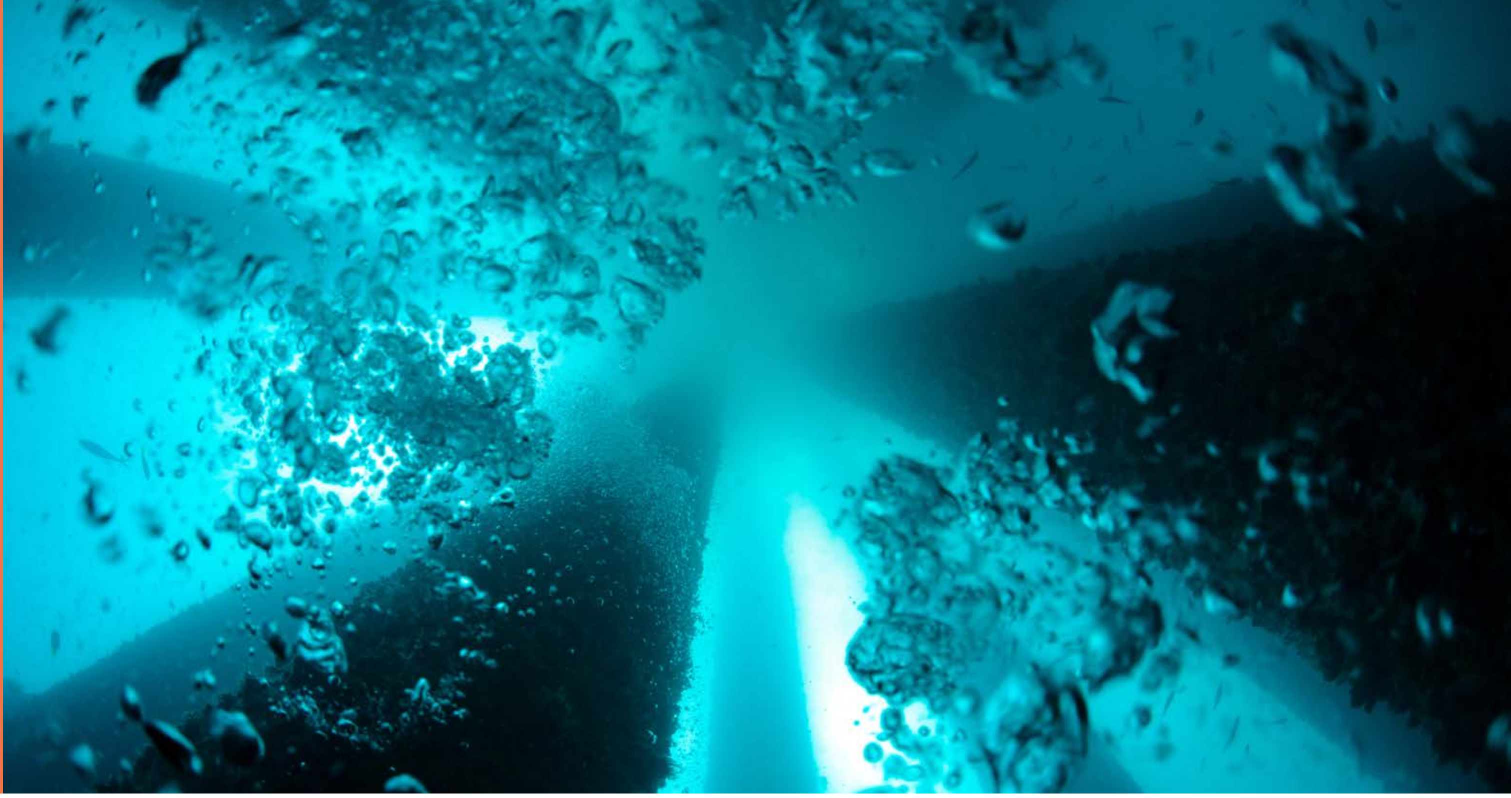
However, it is apparent that there is a substantive difference between the parties concerning the treatment of liabilities and expenses relating to an oil rig, previously owned by the target company (KCA), that was disposed of prior to sale. In the absence of clear terms concerning the issue in the SPA, a dispute has erupted concerning alleged 'representations' made during the sale concerning the oil rig. The case highlights, in respect of drafting and negotiating sale and purchase agreements, it is important that:

- Issues concerning all '*outstanding*' liabilities of the target company are clearly dealt with in the sale and purchase agreements, whether by way of a completion mechanism or otherwise.
- All representations should be contained in the sale and purchase agreements, such that they are clearly recorded by the parties and there is no dispute as to their existence.

Absent such clarity, there will be the opportunity for disputes in the event that the parties have a different recollection of the 'deal' or the deal moves financially against one of the parties and it wishes to re-negotiate through commencing a dispute.

The case also provides litigation lawyers with a useful reminder of the tactical advantages that may be gained by seeking summary judgment of a claim. In this case, the Commercial Court did not award summary judgment but required that, in order to proceed, the defendants, Nestoil, pay the full US$2 million into Court as security for continuing its defence. Whilst the bar is high for a successful summary judgment application, even an unsuccessful application may result in gaining security over the defendant that will increase the prospects of enforcement in the event of a final success. In doing so, it will force the responding party to carefully consider the evidence and the underlying merits of its case at an early stage. This may bring about a tactical advantage in relation to any settlement discussions, particularly where (as in this case) the Court agrees that the responding party's claim is weak.

Judge: Teare J.



Assignment and notice provisions

In relation to many aspects of the oil and gas industry, ranging from M&A deals to hydrocarbons sales contracts, rights to assign and notice provisions remain an important aspect in managing asset portfolios. The past twelve months have seen a number of cases of interest relevant to the sector:

— In the context of widely used non-recourse receivables financing, the Commercial Court in *National Bank of Abu Dhabi PJSC v BP Oil International Ltd* [2016] EWHC 2892 (Comm) considered the impact of restrictions on assignment contained in the underlying sale and purchase agreement on the validity of the financing transaction.

— The Commercial Court in *PJSC Tatneft v Bogolyubov and others* [2016] EWHC 2816 (Comm) considered whether a Russian oil company had any right to bring a claim for recovery of funds against a number of Ukrainian businessmen which it was argued had been assigned to it.

— In *Grimes v Trustees of the Essex Farmers and Union Hunt* [2017] EWCA Civ 361 the Court considered whether notice had been validly served when served on an old address contained in the contract.

Non-recourse receivables financing – representations and warranties on assignment

In the oil industry, sellers sometimes seek to secure revenue streams from sales of crude oil. One method used is to enter into a form of non-recourse receivables financing under which the seller receives a cash advance from a bank and in return transfers to that bank the debt it is due from the buyer (along with the credit risk of the buyer failing to make payment). In return, the bank will take a share of the upside and seek certain assurances from the seller.

In *National Bank of Abu Dhabi PJSC v BP Oil International Ltd* [2016] EWHC 2892 (Comm), the Commercial Court considered whether a representation and warranty in a non-recourse receivables financing agreement, relating to prohibitions on disposal of receivables, was breached when it turned out that the contract that was the source of the revenue stream contained a limitation on assignment.

The outcome was capable of having a stark impact on the financing that the seller had received from the bank.

Facts

On 9 December 2013, BP Oil International Ltd ('**BP**') and Société Anonyme Marocaine de L'Industrie de Raffinage ('**SAMIR**') entered into an agreement for the Sale and Purchase of Crude Oil which was expressly subject to English law (the '**BP/SAMIR Agreement**'). Under the BP/SAMIR Agreement the parties agreed to enter into a series of sales and purchases in accordance with the terms and conditions set out in the BP/SAMIR Agreement. Payment was due some two months after delivery. By Clause 14, BP's General Terms and Conditions for Sales and Purchases of Crude Oil (2007 edition) ('**BP's General Terms and Conditions**') were incorporated. Section 34 of BP's General Terms and Conditions ('**Section 34**') provided:

> *'Section 34 – Limitation on Assignment*
>
> *Neither of the parties to the Agreement shall without the previous consent in writing of the other party (which shall not be unreasonably withheld or delayed) assign the Agreement or any rights or obligations hereunder. In the event of an assignment in accordance with the terms of this Section, the assignor shall nevertheless remain responsible for the proper performance of the Agreement. Any assignment not made in accordance with the terms of this Section shall be void.'*

On 3 September 2014, National Bank of Abu Dhabi PJSC ('**NBAD**') and BP entered into an agreement for the purchase by NBAD of 95% of a debt owed to BP by SAMIR in respect of an oil consignment subject to the terms of the BP/SAMIR Agreement (the '**Purchase Letter**').

The Purchase Letter represented a form of non-recourse receivables financing under which BP transferred almost all of the credit risk of SAMIR failing to make payment to NBAD and received a cash advance in respect of the debt due from SAMIR in advance of the date on which the underlying invoice was due for payment.

Under the Purchase Letter, BP agreed, amongst other things, that by selling 95% of the receivable it had assigned to NBAD '*in equity irrevocably*' the purchased part of the receivable. BP also went on to represent and warrant to NBAD that it was:

> *'…not prohibited by any security, loan, or other agreement… from disposing of the Receivable evidenced by the Invoice as contemplated herein and such sale does not conflict with any agreement binding on [BP].'*

Further, under the Purchase Letter, BP was to reimburse NBAD for a specified sum if any such representation or warranty was breached.

NBAD made payment to BP for the debt pursuant to the terms and conditions of the Purchase Letter but subsequently received no payment of the debt. In November 2014, NBAD learned that SAMIR had filed for insolvency in Morocco and requested that BP seek a '*full and legal assignment*' in respect of the debt that was compliant with Moroccan law. BP responded that they would need to seek consent from SAMIR pursuant to BP's General Terms and Conditions. Accordingly, NBAD made a claim against BP for breach of representation and warranty under the Purchase Letter and claimed for reimbursement of the payment made by NBAD in respect of the debt (as well as interest).

The Commercial Court was asked to consider only one issue of contractual interpretation: whether or not the representation and warranty that BP was not prohibited from transferring the debt to NBAD under any other agreement meant that the representation and warranty given by BP to NBAD was false.

Commercial Court Decision

BP raised three distinct defences to NBAD's claim that the representation and warranty was false:

— The representation and warranty relates to a prohibition '*from disposing of the Receivable*'. In this respect, '*disposal*' means transfer of the right to receive proceeds. There are two routes by which NBAD may be paid (i) via a payment from BP of funds received from SAMIR or (ii) by direct payment from SAMIR. Only if both of these routes are prohibited by '*any security, loan, or other agreement*' is BP in breach of the representation and warranty.

— The representation and warranty given applied to a prohibition in '*any security, loan, or other agreement*' and not '*the Contract*' in which Section 34 was found.

— The assignment made to NBAD was an assignment of the fruits of the proceeds of the relevant transaction under the BP/SAMIR Agreement and not any right or obligation under that contract. As such, Section 34 did not restrict or prohibit such assignment.

NBAD disagreed. On its case, the representation and warranty must be read in the context of the assignment to '*in equity irrevocably*'. Such assignment was of value, as upon giving notice it could bring proceedings in its own name and avoid subsequent set-offs that SAMIR might have against BP.

The Commercial Court considered that the Purchase Letter contained an '*express and unequivocal*' agreement between the parties that BP had transferred the relevant part of its debt to NBAD.

In this context, the Commercial Court decided that the flaw in BP's position is that it confuses two quite different issues. Whether or not NBAD would have additional methods of recourse (or disposal) unaffected by any prohibition on assignment does not mean that BP is not liable for breach of its warranty and representation that it was not prohibited by any other agreement from making the contemplated (equitable) assignment. The existence of alternative or additional rights does not detract from the fact that assignment was at least a (and indeed the primary) method of disposal or sale contemplated in the Purchase Letter. When the assignment and warranty clauses are read together, the warranty and representation was to protect NBAD against BP, by its own acts, having disabled itself from delivering on the promise to assign the underlying debt.

The Commercial Court dealt with BP's other two points swiftly, deciding that (i) '*other agreement*' was broad and covered the BP/SAMIR Agreement and (ii) the assignment was an equitable assignment of a debt; under the BP/SAMIR Agreement it was not merely an assignment of '*fruits of proceeds*'.

Court of Appeal Decision

On 27 July 2017, the Court of Appeal allowed BP's appeal on an expedited basis. However, reasons were reserved and at the date of publication not available.

Comment

The Commercial Court's decision has an important financial impact. BP has effectively sought to deal with the insolvency risk that SAMIR might expose it to by 'selling' that risk to NBAD. In return for taking a 'cut' NBAD would take the risk of non-payment by SAMIR.

As a consequence of the Commercial Court's decision that arrangement would have been unwound and, in the event of an actual insolvency occurring, BP would find itself exposed to the very risk that it had contracted to avoid.

The Court of Appeal's reasoning is not yet available. However, the decision will doubtless be of interest to those with non-recourse financing.

As an interesting side note to the decision, this was the first case conducted under the pilot Shorter Trials Scheme. The case was heard in the Commercial Court in a day with a judgement handed down within two weeks. The parties have been praised for the '*co-operative spirit in which the litigation was conducted*' and demonstrates the benefit of using the Shorter Trials Scheme to produce a resolution to disputes within a commercial time frame. It is understood that the costs of the process were substantially lower than would have been the case under the usual procedure.

Judges: Gloster LJ, Patten LJ, Briggs LJ.

Failure to validly assign rights and claims

The Commercial Court in *PJSC Tatneft v Bogolyubov and others* [2016] EWHC 2816 (Comm) found that a Russian oil company had no right to bring a claim for recovery of funds against a number of Ukrainian businessmen, as there had been no proper assignment of such a right of recovery.

The case serves as a reminder of the complexities of properly assigning interests in rights and claims.

Background

In March 2016, PJSC Tatneft ('**Tatneft**'), one of Russia's largest oil producers, raised a Commercial Court action against four prominent Ukrainian businessmen – namely Mr Gennady Bogolyubov, Mr Igor Kolomoisky, Mr Oleksandr Yaroslavsky, and Mr Pavel Ovcharenko (the '**Defendants**'). The action was raised exclusively under Russian law and was founded on specific provisions of the Russian Civil Code. Tatneft's claim totalled US$334.1 million together with interest.

The basis of Tatneft's claim was that the Defendants took part in a dishonest scheme to misappropriate significant sums allegedly due to Tatneft. Those alleged sums related to oil sums which Tatneft argued should have been paid to Tatneft in respect of oil delivered to the Kremenchug oil refinery (the '**Refinery**') in Ukraine in 2007. Tatneft asserted that the misappropriation of funds did not involve the Defendants directly as individuals, but rather the Defendants siphoned the funds through an elaborate chain of contracts and sham transactions involving a number of intermediate companies.

The Refinery was owned by Ukrainian company, PJSC Transnational Financial and industrial company ('**UTN**'). Although the oil was delivered to the Refinery by pipeline, it was not sold directly by Tatneft to UTN. Instead, four intermediate companies were involved in the transaction: (1) Kompaniya Suvar-Kazan ('**S-K**'), which contracted to on-sell the oil to Private Multi-Sector Production-Commercial Enterprise AVTO ('**Avto**') (the '**Suvar-Avto Framework Contract**'). As Tatneft's 'commission agent', S-K had responsibility for the logistics involved in exporting the oil from Russia; (2) Avto, itself acted as a 'commission agent' for Taiz LLC ('**Taiz**'); (3) Taiz was party to a number of contracts with UTN, under which it agreed to sell oil to UTN, as well as being party to other sale contracts with (4) Tekhno-Progress Scientific and Production LLC ('**Tekhnoprogress**'), a company which on-sold to UTN under its own sale contracts with UTN.

The Refinery was seized in 2007 and thereafter payment for the oil under the chain of contracts ceased. As such, Avto argued that it would be unable to make payments to S-K for oil previously delivered by reason of force majeure under the Suvar-Avto Framework Contract. However, having not been paid itself, Avto had no funds to pay S-K. In April 2008, S-K settled its claims against Avto, with the exception of claims in the sum of US$17.9 million.

S-K and Avto later entered into an agreement (governed by Russian law) with Avto, Taiz and Tekhnoprogress (the '**2008 Assignment Agreement**'), under which the payment obligations of Avto to S-K in the amount of US$421 million were terminated and Taiz's and Tekhnoprogress' payment rights against UTN (as well as Avto's payment rights against Taiz) were assigned to S-K, with amounts in Ukrainain hryvnai ('**UAH**') being converted as at the date of the agreement. The effect of this settlement was that S-K remained fully entitled to be paid for the oil, but directly from UTN rather than through the other intermediary companies.

As per the terms of the 2008 Assignment Agreement, in May 2008 S-K gave notice of the assignment of Taiz and Tekhnoprogress' claims to UTN and demanded payment from UTN in the sum of UAH 2.1 billion. In order to recover this sum from UTN, S-K was required to commence proceedings against UTN in the Arbitrazh Court of the Republic of Tatarstan. The Arbitrazh Court found UTN liable to pay S-K UAH 2.4 billion (the '**Tatarstan Judgment**').

During this period, however, UTN had brought proceedings against S-K in Ukraine, obtaining a judgment declaring that the 2008 Assignment Agreement was invalid as a matter of Ukrainian law and therefore blocking S-K from enforcing the Tatarstan Judgment in Ukraine. The effect of the Ukrainian Judgment was significant as the vast majority of UTN's assets were located in Ukraine. S-K's ability to recover sums from UTN under the Tatarstan Judgment was limited to its recovery of US$105.3 million against UTN's assets in Russia through Enforcement Order No. 265221, which had been issued in December 2008 (the '**Russian Enforcement Order**').

Facts

Tatneft's case, advanced under Article 1064 of the Russian Civil Code, was that the alleged actions by the Defendants involving Avto, Taiz and Tekhnoprogress were unlawful, and each of the Defendants were liable to compensate S-K for the damage it had suffered. Tatneft argued that, but for the Defendants' actions, Taiz and Tekhnoprogress would have paid Avto, and

Avto would have paid S-K US$439.4 million under the Suvar-Avto Framework Contract. After giving credit for the US$105.3 million recovered by way of enforcement of the Tatarstan Judgment, damages were sought in the sum of US$334.1 million, plus interest amounting to US$34.3 million.

Tatneft brought the action as purported assignee of S-K. The scope of the assignment was detailed in a contract described as a 'Compensation Agreement' dated 22 October 2015 (the '**2015 Compensation Agreement**').

The 2015 Compensation Agreement describes S-K as the 'Debtor' and Tatneft as the 'Creditor'. The recital, in its second bullet point, stated as follows:

> *'The Debtor [S-K] has claims against Closed Joint Stock Company Transnational Financial and Industrial Oil Company Ukrtatnafta (according to the company's official website, in 2010 it changed its name for Public Joint Stock Company Transnational Financial and Industrial Oil Company Ukrtatnafta …, registered under the laws of Ukraine, state registration No. 00152307, with its registered office at: Ukraine, 39609, Poltava Region, Kremenchug, Ul. Svishtovskaya, 3 (hereinafter 'TFIOC UTN'), in the amount of one billion six hundred fifteen million eight hundred fourteen thousand nine hundred seventy-six Ukrainian Hryvnas (UAH 1,615,814,976) in principal, plus all interest accrued and subject to accrual in the future (hereinafter, the 'Claims').'*

The operative part of the 2015 Compensation Agreement provided as follows in Clauses 1.1, 1.2, 1.3 and 1.4:

> *'1.1 In partial discharge of the obligations owing to the Creditor and referred to in clause 1.2.1 hereof the Debtor shall provide compensation to the Creditor pursuant to Article 409 of the Russian Civil Code and on the terms set forth herein.*
>
> *1.2 Details of the Debtor's obligations to the Creditor:*
>
> *1.2.1 the aggregate amount of the outstanding monetary obligations of the Debtor owing to the Creditor is eighteen billion one hundred twenty-three million six hundred forty one thousand six hundred sixty-two Rubles 89 kopecks (RUB 18,123,641,662.89) (hereinafter, the 'Obligations');*
>
> *1.2.2 the Obligations arise under the Commission Agency Agreement and the Assignment Agreement;*
>
> *1.2.3 part of Obligations in respect of which the compensation is provided, amounts to one hundred twenty-eight million seven hundred seventy-one thousand nine hundred fourteen Rubles 42 kopecks (RUB 128,771,914.42), including:*
>
> *- One hundred twenty-eight million seven hundred sixty-one thousand six hundred twelve Rubles 67 kopecks (RUB 128,761,612.67) as part of the obligations arising out of the Commission Agency Agreement;*
>
> *- Ten thousand three hundred one Rubles 75 kopecks (RUB 10,301.75) as part of the obligation arising out of the Assignment Agreement. The Debtor's Obligations to the Creditor shall be discharged pro rata to the amount of the Obligations.*
>
> *1.3 In discharge of part of the Obligations the Debtor on the date hereof shall transfer compensation to the Creditor, and the Creditor shall accept such compensation being the Debtor's Claim against TFIOC UTN in the amount of one billion six hundred fifteen million eight hundred fourteen thousand nine hundred seventy-six Ukrainian Hryvnas (UAH 1,615,814,976) in principal, plus all interest accrued and which may continue to accrue, arising under the following documents:*
>
> *1.3.1 Deed of Assignment dated 18 April 2008 between LLC 'Kompaniya 'Suvar-Kazan' (currently LLC 'Kompaniya 'Fenix'), Private Multi-Industry Production and Commercial Enterprise Avto, registered in accordance with the Ukrainian laws (state registration number 13951872), Limited Liability Company TAIZ, registered in accordance with the Ukrainian laws (state registration number 32635669), and Research and Development and Manufacturing Limited Liability Company TEKHNO-PROGRESS, registered in accordance with the Ukrainian laws (state registration number 30601617);*
>
> *1.3.2 Judgment of the Arbitration Court of the Republic of Tatarstan issued on 05 September 2008 in case No. A65-9070/2008-sg2-4;*
>
> *1.3.3 Enforcement Order No.265221 issued on 03 December 2008.*
>
> *1.4 The Claims transferred by Debtor to Creditor as compensation under the Agreement also*


include all other rights available to Debtor as of the time of execution of the Agreement and associated with and/or arising from the Claims and/or directly or indirectly related in any way to the non-payment of sums owed to the Debtor under any or all of the documents set forth in Clauses 1.3.1 to 1.3.3 hereof, including, but not limited to: (1) the Debtor's right to require TFIOC UTN and/or any third parties to make any payments: (a) by way of indemnification and/or liquidated damages (fines, penalties) caused by a default, delay or another undue performance; (b) in the form of interest payable for unlawful use of other people's money, (c) by way of reimbursement of litigation costs and other expenses related to the lawsuit; (2) the Debtor's claims against TFIOC UTN and/or third parties arising from damages caused and/or unjust enrichment; and (3) the Debtor's right to sue TFIOC UTN and/or third parties, and the Debtor's right to seek enforcement of obligations before competent authorities and/or file a criminal complaint against TPIOC UTN and/or third parties.'

Tatneft would argue that the wide language of the 2015 Compensation Agreement, particularly in Clause 1.4, was typical of agreements where the intentions of the contracting parties were to include every possible claim available to the assignor in the wording of the assignment. Tatneft asserted that both S-K and Tatneft had clearly intended to assign all claims which it might have against third parties in relation to the non-payment of the oil to Tatneft. According to Tatneft, this would also include tortious claims against third parties.

The Defendants argued that, on the proper construction of the 2015 Compensation Agreement, S-K assigned only its claims against UTN and/or third parties which arose under the 2008 Assignment Agreement, the Tatarstan Judgment, and the Russian Enforcement Order. This was made clear by the operative Clauses 1.3 and 1.4, which were based on the premise of the 2008 Assignment Agreement having had the effect that the previous chain of contracts no longer operated. Therefore, the Defendants asserted that there was no scope to read the assignment as also covering a claim on the part of S-K based on a failure of the intermediary companies to pay monies up a contractual chain, which no longer existed.

Decision

The Commercial Court found that the language used in Clauses 1.3 and 1.4 was clear and that the 2015 Compensation Agreement did not include claims brought against any third party which could not be brought under the documents listed in Clause 1.3, namely: the 2008 Assignment Agreement, the Tatarstan Judgment and the Russian Enforcement Order.

In reaching this decision, the Commercial Court placed significance on the second recital, which defined '*Claims*' as the claims which the '*Debtor*' (S-K) had against UTN. These were claims which the Commercial Court stated could only be made under the 2008 Assignment Agreement as a claim under that agreement was the only direct claim which, at that or any other stage, S-K had against UTN.

The Commercial Court also found that the second recital was consistent with Clause 1.3, which provided for the discharge of S-K's '*Obligations*' under the Suvar-Tatneft Commission Agreement by S-K transferring to Tatneft 'compensation' in the same amount as that described in the second recital (UAH 1,615,814,976) '*being the Debtor's Claim against … TFIOC UTN … arising under the following documents*', the 2008 Assignment Agreement, the Tatarstan Judgment and the Russian Enforcement Order. The Commercial Court stated that, under Clause 1.3, the transfer to Tatneft from S-K was S-K's claim, first, against UTN, rather than any other party and, secondly, under those three '*documents*', rather than under any other '*documents*'.

The Commercial Court considered that although Clause 1.4 was worded broadly, the focus of that wide language ('*rights … associated with and/or arising from the Claims and/or directly or indirectly related in any way*') remains on the '*documents set forth in Clauses 1.3.1 to 1.3.3 hereof*', specifically on '*the non-payment of sums owed to the Debtor under any or all*' of those documents. As such the Commercial Court did not agree that this broad language provided an expansion of '*the subject matter of the grant*' so as to mean that the assignment should be regarded as embracing rights arising wholly independently of the Clause 1.3 '*documents*'. The Commercial Court went further to state that this point was strengthened by the fact that nowhere in the 2015 Compensation Agreement was there any mention of the Ukrainian Judgment having declared that the 2008 Assignment Agreement was invalid nor, indeed, any mention of the intermediate companies, Taiz, Tekhnoprogress or Avto, at all.

The Commercial Court therefore found that the rights sought to be asserted by Tatneft in action were not rights which were the subject of the 2015 Compensation Agreement and as a result the Commercial Court found Tatneft had no '*real prospect of success*' in seeking to establish claims against the Defendants.

Comment

This case will serve to remind contract drafters of the importance of the use of clear and unambiguous language when drafting and negotiating contracts that seek to assign certain rights from one party to another.

In this case, Tatneft's whole claim was refused as a result of the use of language contained in the 2015 Compensation Agreement that, when properly analysed, did not contain sufficient words to assign the claim that formed the subject matter of the dispute. In fact, the words suggested clearly, in the view of the Commercial Court, that it was something else that was assigned. Although, it may have appeared apparent to Tatneft, in its subjective view, that the contracting parties had intended to assign all claims which it might have against third parties in relation to the non-payment for the oil, the Commercial Court found this was not reflected in the wording of the clause or the wider assignment agreement.

Whilst the Commercial Court was required to decide the case under Russian law, the case has many parallels with how the Courts would consider similar disputes brought under English contract law. Namely, that the Court will primarily seek to analyse the natural and ordinary meaning of the words as explained in *Arnold v Britton* [2015] UKSC 36 and more recently in *Wood v Capita Insurance Services Limited* [2017] UKSC 24. If the wording of the contract is clear, as the Commercial Court found in the Tatneft case, then the Court will be slow to depart from the natural and ordinary meaning of the words.

In addition to the issue above, it is imperative that contracting parties who intend to assign a right identify precisely the right or rights that are intended to be assigned and thereafter ensure that those rights are indeed freely assignable.

Judge: Picken J.

Notices: Change of address and validity

In *Grimes v Trustees of the Essex Farmers and Union Hunt* [2017] EWCA Civ 361 the Court of Appeal adopted a commercial approach to the interpretation of a notices provision in a lease.

In doing so, it decided that a landlord had not given valid notice, as the notice was sent to the old address in the contract, rather than a subsequently notified address. The case is a reminder of the importance of notice provisions and sending notices to any updated address.

Although not an oil and gas industry case, it will have resonance for the sector.

Facts

An agricultural tenancy agreement provided that any notice may be served on a party to the agreement:

> *'at the address given in the Particulars [in the agreement] or such other address as has previously been notified in writing.'*

The evidence showed that the tenant had given written notice to the landlord that he had changed his address. Some six years later, the landlord served a Notice to Quit at the tenant's original address given in the Particulars. The tenant claimed that he knew nothing about the notice as it was served at the wrong address.

The issue was whether the landlord had validly served its Notice to Quit and, therefore, whether the agreement had validly terminated.

The High Court at first instance decided that the notice had been validly served. The original address was still a valid address for service, because the agreement allowed for the notice to be served at the address given in the Particulars, even though the landlord had many years earlier received a notice of the tenant's change of address. The judge considered that the natural and ordinary meaning of the words was clear.

Court of Appeal Decision

The Court of Appeal disagreed and decided that the notice had been invalidly served and, therefore, the agreement had not been validly terminated.

The Court of Appeal adopted principles of construction from the Supreme Court decision in *Arnold v Britton* [2015] UKSC 36. In addition, one day after the hearing, the Supreme Court delivered judgment in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24 ('***Wood***'), to which the parties' counsel drew the Court of Appeal's attention.

The Court of Appeal considered that the first instance decision would be a '*surprising conclusion to have to reach, particularly in the context of a contractual relationship that was intended to last for at least six years*'. It may well be asked, what is the point of enabling the tenant to notify the landlord of his new address, if the landlord remains free to serve notices on the tenant at the address given in the Particulars?

As a matter of commercial common sense, the parties must have intended that the new address, once duly notified, should supersede the original one shown in the Particulars. Otherwise, the situation would be reached where an unscrupulous landlord, in full knowledge of the tenant's actual current address, could continue to send notices to the tenant's original address years after he had moved from it, and long after any normal arrangements for the forwarding of mail or other documents addressed to him there would have expired.

On this basis, the Court of Appeal was disposed, if the language of the Clause permitted it, to construe the provision as substitutive in its effect. Or in other words, once the tenant has given written notice of a new address under the Clause, that new address then replaces the original one shown in the Particulars (or any previous replacement address notified, as the case may be).

There is no difficulty in construing the Clause in this way. The normal meaning of the word 'or' is disjunctive, although in a suitable context it can be read as equivalent to 'and', or as expressing a non-exclusionary alternative equivalent to 'and/or'. As a matter of ordinary language, therefore, it is natural to begin with a rebuttable presumption that the clause provides for service either at the address given in the Particulars or at such other address as has previously been notified in writing, but not at both. Furthermore, The Court of Appeal can find nothing in the context to support the notion that 'or' was here intended by the parties to mean 'and' or 'and/or'.

On the footing that the two modes of service are true alternatives, the next question is whether the party serving the notice was intended to have a choice between them, or whether notification of a new address was intended to replace the address given in the Particulars. The answer to this question seemed to the Court of Appeal to be obvious. The parties cannot sensibly have intended that the serving party should continue to have the option of serving at the old address once he has been notified of the new one. That is to say, the parties must have intended that the new address should be a substitute for its predecessor, and not that it should offer a choice which did not exist before notification of the new address.

Another way of making the same point is to say that the disjunctive language of the Clause envisages only a single address for service: either the address given in the Particulars, or (instead) such other address as has previously been notified in writing. To construe the Clause in this way does not involve reading anything into it, and is indeed the natural and ordinary meaning of the language used. In particular, the use of the word 'other' before 'address' in the second limb of the clause is a strong indication that the new address is intended to replace that shown in the Particulars.

In reaching the contrary conclusion, the High Court thought that '*the literal meaning*' of the words used in the Clause was clear. However, *Wood* makes clear that English law does not take a literal approach.

Unless the notice was sent to the new address, as a consequence of the above, the landlord had not given valid notice.

Comment

The decision of the Court of Appeal will likely, be broadly welcomed as reflecting a 'common sense' approach to construction of the notice provision in question. However, the existence of the case is a good reminder of a number of important aspects concerning notice provisions:

— It is likely that notice provisions in many oil and gas contracts will be required to operate over an elongated time horizon. Clear drafting in relation to how changes of address should be dealt with is important.

— In this context, it is important that; (i) the process for change of address is clear; (ii) it is made clear in the contract whether this address supersedes the address given in the relevant contract (or any other relevant contract); and (iii) a record is kept of such changes.

— When issuing notices, a check is carried out for any change of address after the contract has been signed. In the absence of establishing such facts, any purported notice may be sent to the incorrect address and be invalid.

Judges: Beatson LJ, Macur LJ, Henderson LJ.

Limiting or excluding liability: 'consequential loss' clauses and the Unfair Contract Terms Act

The 2015 and 2016 Annual Review each contained substantial sections on 'consequential loss' clauses. Notwithstanding *Transocean Drilling UK Ltd v Providence Resources* [2016] EWCA Civ 372 (see 2016 Annual Review, page 28), issues of 'consequential loss' exclusion and other exclusion clauses continue to be a fertile area for guidance from the English Courts.

— In *Star Polaris LLC v HHIC-Phil Inc* [2016] EWHC 2941 (Comm), the Commercial Court considered whether 'consequential loss' (undefined) in an exclusion clause equated to the second limb of *Hadley v Baxendale* (1854) 9 Ex. 341.

— In *African Export-Import Bank (and Others) v. Shebah Exploration & Production Company Limited (and Others)* [2017] EWCA Civ 845 the Court of Appeal considered whether transacting on an industry model form was '*dealing on standard terms*' for the purposes of UCTA.

Excluding 'consequential loss' can restrict 'direct' damages

The Commercial Court was recently asked to consider the correct construction of the phrase '*consequential or special losses or expenses*' in a clause that distributed (and limited) liability and remedies between parties (*Star Polaris LLC v HHIC-Phil Inc* [2016] EWHC 2941 (Comm)). In distinguishing existing Court of Appeal authority that suggested that such words equate to the second limb of *Hadley v Baxendale* (1854) 9 Ex. 341, the Commercial Court gave the words an expansive meaning that severely restricted the remedies available to the wronged party. The approach adopted by the Commercial Court will be relevant to drafters of such clauses across the oil and gas industry.

Facts

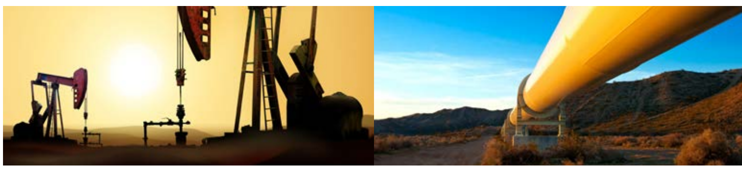
Star Polaris LLC (the '**Buyer**') and HHIC-PHIL Inc (the '**Shipbuilder**' or '**Builder**') entered into a contract dated 6 April 2010 (the '**Contract**') for the construction of the STAR POLARIS (the '**Vessel**'). The Contract was a variant of the Shipbuilders Association of Japan ('**SAJ**') standard form.

Article IX of the Contract stated:

> *'ARTICLE IX*
>
> *1. Guarantee of Material and Workmanship*
>
> *The Builder […] guarantees the VESSEL and all parts and equipment thereof that are manufactured or furnished by the BUILDER under this CONTRACT or its Subcontractors or its suppliers against all defects which are due to defective materials, design error, construction miscalculation and/or poor workmanship, provided such defects have not been caused by perils of the sea, rivers or navigation, or by normal wear and tear, overloading, improper loading or stowage, fire, accident incompetence, mismanagement, negligence or wilful neglect by the BUYER or by alteration or addition by the BUYER not previously approved by the BUILDER, unless such an event was caused by an act or omissions of the BUILDER.*
>
> *[…]*
>
> *3. Remedy of Defects*
>
> *(a) The BUILDER shall remedy, at its expense, any defects against which the VESSEL is guaranteed under the Article, by making all necessary repairs or replacements at the SHIPYARD, if reasonably practicable or elsewhere as provided for in herein below.*
>
> *(b) In any cases, removal of the VESSEL to the location at which the repair or replacements are to be effected, shall be at the BUYER's risk and expenses.*
>
> *[…]*
>
> *4. Extent of BUILDER's Liability*
>
> *(a) After delivery of the VESSEL the responsibility of the BUILDER in respect of or in connection with the VESSEL or this CONTRACT shall be limited to the extent expressly provided in the Paragraph 4 of this Article. Except as expressly provided in this Paragraph, in no circumstances and on no ground whatsoever shall the BUILDER have any responsibility or liability whatsoever or howsoever arising in respect of or in connection with the VESSEL or this CONTRACT after the delivery of the VESSEL. Further, but without in any way limiting the generality of the foregoing, the BUILDER shall have no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses unless otherwise stated herein.*
>
> *[…]*
>
> *(d) The liability of the BUILDER provided for in this Article shall be limited to defects directly caused by defective materials, design error, construction miscalculation and/or poor workmanship as above provided. The BUILDER shall not be obliged to repair, nor be liable for, damage to the VESSEL or any part of the equipment thereof, which after delivery of the VESSEL, is caused other than by the defects of the nature specified above. The guarantees contained as hereinabove in this Article replace and exclude any other liability, guarantee, warranty and/or condition imposed or implied by statute, common law, custom or otherwise on the part of the BUILDER by reason of the construction and sale of the VESSEL for and to the BUYER.'*

The Shipbuilder delivered the Vessel to the Buyer. However, during the 12-month warranty period, the Vessel suffered a serious engine failure. The Shipbuilder denied liability and the Buyer commenced arbitration against it for breaches of the Contract and claimed compensation, which included:

- The cost of repairs to the vessel; and
- Towage fees, agency fees, survey fees, off-hire and off-hire bunkers caused by the engine failure.



During the hearing, the Buyer indicated that it also wished to make a claim for diminution in value of the Vessel.

The Shipbuilder sought to rely upon the exclusion for '*consequential or special losses*', as excluding claims for all damages that were not the cost of repair. However, the Buyer argued that '*consequential or special losses*' only excluded the very narrow category of damages identified in the second limb of *Hadley v Baxendale*.

Arbitral Tribunal Award

The arbitral tribunal decided that the exclusion of liability for '*consequential or special losses, damages or expenses*' contained in Article IX of the contract excluded liability for all losses (including financial loss consequent upon physical damage), except the obligation to remedy any defects by making all necessary repairs and replacements. In that context, '*consequential or special losses*' had a wider meaning than in the second limb of *Hadley v Baxendale*.

Commercial Court Decision

The Buyer appealed against the award.

The Buyer argued that:

- The words 'consequential loss' have an established meaning as a matter of law, which is the second limb of *Hadley v Baxendale*. Whilst it had been questioned whether this meaning remains correct, it is the subject of Court of Appeal authority and must be applied by the High Court.
- In the context of the Article in question, the words 'consequential loss' appear with the words 'special losses'. The authorities show that 'special losses' are also the second limb of *Hadley v Baxendale*.
- Additional words deleted from the SAJ form would have excluded 'loss of use'. It would therefore be wrong to construe the Contract as a complete code excluding all losses except the cost of repair.

The Commercial Court rejected the Buyer's arguments and upheld the arbitral tribunal's award. In reaching the decision the Commercial Court reasoned that:

- Notwithstanding any authorities, a clause fell to be construed on its own wording and in the context of the contract in dispute;
- It can no longer be said that exclusion clauses are to be read narrowly when they appear in commercial contracts; the wording must be given its natural and ordinary meaning – where there is ambiguity the *contra proferentum* rule may play a role;
- The last sentence of Article IX.4(d) makes plain that Article IX provided a complete code for the determination of liability;
- Once it is accepted that Article IX of the contract provides a complete code for the determination of liability, the issue is '*not therefore a question of simply determining what liability is excluded, but ascertaining what liability is undertaken*';
- Because Article IX sets out a complete code, the only express provision in Article IX.4 of responsibility and liability post-delivery of the Vessel is the liability in Paragraph 4(d) for defects. Further, that liability can only refer to Article IX.3 and the obligation to repair physical damage; and
- It was therefore also necessary to read the words in Paragraph 4(a) '*except as expressly provided in this Paragraph*' as '*except as expressly provided in this Article*', as they were a reference to the remedies in Paragraph 3 – otherwise there would be no express provision for liability.

The only positive obligations assumed under the guarantee were the repair or replacement of defects and physical damage caused by such defects.

Further, the Commercial Court decided that the reference to '*consequential or special losses, damages or expenses*' in Article IX of the Contract did not mean such losses, damages or expenses as fall within the second limb of *Hadley v Baxendale* but does have the wider meaning of financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage. The claim for diminution in value was also considered to be a claim for '*consequential or special loss*' and was therefore excluded (even though it might well have fallen within the first limb of *Hadley v Baxendale*).

Comment

The arbitral tribunal and the Commercial Court appear to have been strongly influenced by the fact that it was considered common ground between the parties that Article IX was a complete code which meant that, in order to succeed, the Buyer had to bring its claim within its terms. The exact scope of the Buyer's concession is not apparent from the judgment.

However, once it was accepted that Article IX was a complete code, the scope of the '*consequential or special loss*' exclusion was deemed somewhat secondary to the Buyer's need to identify an '*inclusive remedy*' under which it may make a claim. Absent such express right, no claim could be sustained.

From a drafter's perspective, the Commercial Court's decision highlights the difference between seeking to create a complete code, where all remedies must be expressly identified, and seeking to exclude common law remedies, where the explicit wording might be needed to achieve an exclusion of a remedy.

That said, the decision does raise some interesting issues for construction of 'consequential loss' exclusion clauses:

— The decision intimates that following *Transocean Drilling v Providence Resources* [2016] EWCA Civ 372, English law will no longer read exclusion clauses agreed between commercial parties narrowly (it is of interest in this regard that *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] A.C. 689 was not even cited by the Commercial Court); and

— The decision suggests that the emphasis that English law places on the words used by the parties, viewed against the relevant factual matrix, means that legal authorities concerning the meaning of the words 'consequential loss' in the context of a contractual clause distributing risk should be viewed with care and might not apply to all contracts.

It is apparent that the debate about the scope of exclusions generated by 'consequential loss' clauses remains very much post-*Transocean Drilling v Providence Resources*. Lord Hoffmann queried in *Caledonia North Sea v British Telecommunications* [2002] UKHL 4 whether the Court of Appeal cases that equate the words 'consequential loss' in contracts to the second limb of *Hadley v Baxendale* are correct. In fact, Lord Hoffmann questioned the whole premise of *Hadley v Baxendale*: '*although an excellent attempt was made in Hadley v Baxendale to lay down a rule on the subject, it will be found that the rule is not capable of meeting all cases; and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule, as to the legal measure of damages applicable in all cases.*' (Hoffmann, The Achilleas: custom and practice or foreseeability? (2010) 14(1) Edin. L.R. 47-61). The issue was also raised in Ashley, Palmer and Aldersey-Williams '*An International Issue: 'Loss of Profits' and 'Consequential Loss*'' (2014) 15 Business Law International Journal 261.

It remains to be seen whether the Commercial Court decision in this case is followed. However, it appears to add an additional layer of uncertainty and complexity to an already knotty area of English law. In the interim, drafters should continue to be cautious of using phrases like 'consequential loss' without defining their meaning.

Judge: Cooke J.

Oil and Gas: UCTA and Exclusion Clauses

The arguments concerning the applicability of an exclusion clause in the face of extreme conduct by the party relying on that clause are familiar to most practitioners in the oil and gas sector. What is perhaps less familiar is the potential impact of the Unfair Contract Terms Act 1977 ('**UCTA**'), especially where one party is dealing on its standard terms.

The Court of Appeal has considered this matter recently in *African Export-Import Bank (and Others) v. Shebah Exploration & Production Company Limited (and Others)* [2017] EWCA Civ 845. This is only the second time that the Courts have been asked to consider what '*dealing on standard terms*' means, since UCTA came into force. The case also considers whether an industry standard form could be considered to be a party's '*standard terms*'.

Background

In 1934, a certain Mr. Alfred Thompson Denning persuaded the Court of Appeal that, provided the terms of an exclusion clause were clear enough, any liability for breach of contract can be excluded: *L'Estrange v. Groucob* [1934] 2 KB 394.

In 1977, Parliament passed UCTA, Section 3 of which sought to prevent the reliance by a contractor on an exclusion clause where the same appears in the contractor's '*standard terms of business*', except insofar as the term is reasonable.

In June 2017, the Court of Appeal was asked to consider how UCTA should apply to an exclusion clause in a US$150 million facility agreement (the '**Facility Agreement**') between Egyptian and Nigerian banks on the one hand (the '**Banks**') and an African oil and gas E&P company on the other ('**Shebah**').

Facts

Shebah and the Banks executed the Facility Agreement, which was based on a Loan Market Association industry model form (the '**LMA Form**'). The purpose of the Facility Agreement was: (a) to enable Shebah to refinance some of its pre-existing debt; and (b) to provide Shebah with working capital, including funding for the Ukpokiti oil field in Nigeria.


Shebah fell behind with repayments and the Banks accelerated the entire debt. It was not in dispute that the Banks were entitled to accelerate the debt. Aside from alleged counterclaims, it was not in dispute that the sums claimed by the Banks were due.

One of the counterclaims was that the Banks owed US$1 billion for an alleged breach by the Banks of an oral agreement not to accelerate the debts before a certain time, leading to the potential loss by Shebah of its concession rights. Shebah sought set-off of this claim against the Banks' claim.

The Banks relied on Clause 32.6 of the Facility Agreement, which excluded Shebah from relying on a right of set-off. (Note: the clause was not seeking to exclude the Banks' liability entirely, but only to exclude Sheba's right to set-off.) Shebah in turn argued that Section 3 of UCTA prevented the Banks from relying on Clause 32.6 except to the extent that it was reasonable.

The Commercial Court found for the Banks on an application for summary judgment. Shebah appealed.

Court of Appeal Decision

The Court of Appeal noted that before Section 3 of UCTA can be held to apply (and so require an inquiry into the reasonableness of any particular term), the party relying on UCTA (in this case, Shebah) must prove the existence of four characteristics, the first two of which (i) that the term is written; and (ii) it is a term of business) are not controversial.

The Court of Appeal was instead primarily concerned with the remaining two questions: (i) whether the exclusion clause formed part of the Banks' '*standard terms of business*'; and (ii) whether the Banks were '*dealing on those standard terms of business*'.

Standard Terms of Business
It was decided that Shebah must show that the Banks '*habitually used*' the terms of business. It was not enough to show that a model form had been used. The use must be habitual in the sense of '*invariably*' or '*at least usually*'. This can be shown either by practice or by an express statement by the contracting party.

The Commercial Court found no evidence that the Banks habitually used the LMA Form.

The Court of Appeal agreed, adding that Shebah filed no evidence to the effect that they believed the agreement was on the Banks' standard terms. Indeed, it was difficult to see how they could do so on a syndicated loan with Egyptian and Nigerian banks.

Dealing on Standard Terms of Business
The deal must be done on the written standard terms of business. The question was whether there has been negotiation between the parties, the result of which is that some but not all the standard terms are applicable to the deal.

The only other case on this point since UCTA came into force was *St. Albans City DC v. International Computers Ltd* [1996] 4 All ER 481. In that case, the Court of Appeal held that the deal had been done on the defendant's standard terms because those terms remained '*effectively untouched*' by the negotiations. There thus remained an open question as to the approach to take where some of the standard terms are not part of the deal.

The Court of Appeal decided that it was relevant to inquire whether there have been '*more than insubstantial variations*' to the terms that may otherwise have been habitually used by the other party to the transaction. If there have been substantial variations, it is unlikely to be the case that the party relying on UCTA will have discharged the burden of proof to show that the contract has been made '*on the other's written standard terms of business*'.

The Court of Appeal noted the Commercial Court finding that the User Guide to the LMA Form itself states that the LMA Form cannot be used without amendment. Furthermore, the Court of Appeal considered that it could not be right that any defaulting borrower could simply assert that business was being done on standard terms and that the lender then has to disclose the terms of other transactions it has entered into before he is entitled to summary judgment.

There were detailed negotiations between the parties, which rendered it impossible to say that either the LMA Form was, or the terms ultimately agreed were, the Banks' standard terms of business. Some of the agreed changes were of considerable substance. It could not be said that the terms were '*effectively untouched*' and so St. Albans City was distinguished.

The Banks could thus rely upon the set-off exclusion clause.

Comment

The oil and gas industry has not traditionally concerned itself much with the implications of UCTA. Most parties to oil and gas contracts will be sophisticated commercial parties with the benefit of legal advice, which acts as an argument against the application of legislation primarily designed to protect consumers. Furthermore, it was until recently generally understood that oil and gas indemnity regimes would fall outside of UCTA.

However, practitioners in the industry will be aware that UCTA became more of a concern to oil and gas contracts following the decision of the Supreme Court in *Farstad Supply A/S v Enviroco Limited* [2010] UKSC 18, where the Supreme Court showed a willingness to interpret indemnity provisions as exclusions, deciding that the provisions act as indemnities when being used to allocate responsibility for '*third party exposure*' but when the provisions were being used to regulate '*direct exposure to the other contracting party*', the provisions would operate as exclusions. To the extent the indemnities are acting as exclusions, UCTA is relevant – and not just Section 3 as covered by this case, but also, for example, the sections covering exclusion of liability for negligent loss or damage to property (Section 2(2)).

Some oil and gas companies and contractors are willing to rely on the industry standard forms (e.g. the LOGIC suite of contracts, Oil and Gas UK model forms and AIPN model forms). Others may use their own standards; many of these may, in turn, be based upon the industry standard forms.

In this case, the Court of Appeal declined to engage with the Banks' argument that a contract based on the LMA Form can never be made on standard business terms because there is always a need for adaption and amendment. It was held – *obiter* – that such an argument goes too far; if the industry standard was used by a party and amendments were not countenanced, it would be difficult to say that the terms were not that party's standard terms. Ultimately, this was a question to be '*left for another day*'.

It seems from this decision that where commercial parties use an industry model form as the basis for a complex financial contract, executed after the usual process of negotiation, it would require cogent evidence to raise a case that the contract was made on the written standard terms of one of those parties within the meaning of Section 3 of UCTA. Although standard forms are widely used in the oil and gas industry, these are often only a basis for negotiation, with substantial changes being made – it would be rare to find such a standard '*effectively untouched*' by the parties. In fact LOGIC and AIPN model forms generally require significant elements remaining to be agreed by negotiation or selection of optionality.

As such, it seems unlikely that a contract incorporating an industry model form will fall within the scope of UCTA. However, it appears to remain a possibility if one of the parties habitually uses such a contract.

It is also worthy of note that the Court of Appeal made it clear that there is no requirement that negotiations must relate to the exclusion clause, if UCTA is not to apply.

It should also be appreciated that section 27(1) of UCTA requires: '*Where the law applicable to a contract is the law of any part of the United Kingdom only by choice of the parties (and apart from that choice would be the law of some country outside the United Kingdom) sections 2 to 7 and 16 to 21 of this Act do not operate as part of the law applicable to the contract*'.

Judges: Longmore LJ, Henderson LJ.

Joint Operating Agreements and Transportation Agreements

After last year's important decision concerning forfeiture, in *Cavendish Square Holdings B.V. Makdessi* [2015] UKSC 67, this year has seen less activity concerning cases relevant to JOAs and transportation agreements. However, an importance guidance was given in:

- *Pan Petroleum AJE Limited v (1) Yinka Folawiyo Petroleum Co Ltd; (2) YFP Deepwater Co Ltd; (3) EER (Colobus) Nigeria Ltd*; (4) *Newage Exploration Nigeria Ltd; and (5) PR Oil & Gas Nigeria Ltd* [2017] EWHC 1102 (Comm) where the Commercial Court handed down an important decision demonstrating a willingness to intervene on an interim basis to preserve the *status quo*, and prevent the JOA default remedies being exercised, pending the resolution of the issue by arbitration.
- *PT Transportasi Gas Indonesia v Conocophillips (Grissik) Ltd & Anor* [2016] EWHC 2834 (Comm) where the Commercial Court identified the findings of an arbitral tribunal concerning regulatory interference in a contractual transportation tariff.

JOAs – Restraining remedies for default

In the event of a failure to pay a valid cash call, under oil and gas joint operating agreements ('**JOAs**') the non-defaulting parties are traditionally granted a series of remedies against the party in default. As oil prices have fallen, disputes have increasingly arisen as to whether cash calls have been validly issued and therefore whether the remedies under the JOA are available against the alleged 'defaulting party'.

In *Pan Petroleum AJE Limited v (1) Yinka Folawiyo Petroleum Co Ltd; (2) YFP Deepwater Co Ltd; (3) EER (Colobus) Nigeria Ltd; (4) Newage Exploration Nigeria Ltd; and (5) PR Oil & Gas Nigeria Ltd* [2017] EWHC 1102 (Comm) the Commercial Court demonstrated a willingness to intervene on an interim basis to preserve the *status quo*, and prevent the JOA remedies being exercised, pending the resolution of the issue by arbitration. The approach adopted by the Commercial Court could have a significant impact on the conduct of joint operations under JOAs around the world.

Facts

Pan Petroleum AJE Limited ('**Pan Petroleum**'), Yinka Folawiyo Petroleum Co Ltd ('**Yinka**') and the other defendants were parties to an oil mining lease offshore the Federal Republic of Nigeria (the '**Oil Mining Lease**'). The relationship between the joint venture parties was governed by a JOA.

In the event of non-payment of cash calls, the JOA between the parties contained the types of remedy typically found in international oil and gas JOAs. The JOA between the parties required that a party in Default (the '**Defaulting Party**'): (i) loses the right to attend Operating Committee meetings or to vote on any matter before the Operating Committee; (ii) loses the right to its participating share of any hydrocarbons; and (iii) if the Defaulting Party does not remedy its Default after a period of time (being 45 days in this case), it can be compelled to withdraw from the JOA and the Oil Mining Lease (or relevant granting instrument). Although not set out in the decision, it seems from the text of the above provisions contained in the decision that the JOA between the parties is based on the 1995 AIPN Model Form Operating Agreement. It is also apparent from the decision that the JOA requires disputes between the parties to be resolved by arbitration.

A dispute arose between the parties concerning, broadly, the drilling of two development wells within the area covered by the Oil Mining Lease (the '**Development Wells**'). While not set out in the decision itself, we understand that, in late 2016, Pan Petroleum had refused to pay cash call(s) issued in respect of the Development Wells. It refused to do so on the basis that the drilling of the wells was premature. Further, that such operations required unanimous consent of the joint venture partners that had not been obtained. Accordingly, Pan Petroleum argued that any cash calls to the parties in respect of the Development Wells had not been issued in accordance with the JOA.

However, because of its refusal to pay the cash call(s), Pan Petroleum was issued with a Default Notice.

Pan Petroleum applied to the Commercial Court for an interim injunction to prevent the non-Defaulting Parties from exercising any rights or remedies under the JOA in respect of the Development Wells.

Decision – Injunction

Pan Petroleum was successful in its application for an interim injunction to restrain the non-Defaulting Parties from exercising any rights or remedies under the JOA in respect of the Development Wells. The decision granting the interim injunction has not been published, but much can be understood about its terms and significance from subsequent proceedings.

When granting the interim injunction, the High Court's concern was to '*hold the ring for a short period*'.

In particular, the interim injunction prevented the non-Defaulting Parties from exercising or purporting to exercise any of the rights or remedies in the JOA to:

- Vest or transfer Pan Petroleum's entitlement or participating interest in the JOA or the Oil Mining Lease for the non-Defaulting Parties' own benefit;
- Exclude Pan Petroleum from participating in or voting at meetings of the Operating Committee under the JOA; or
- Terminate the JOA or any other remedy that would deprive Pan Petroleum from its entitlement and/or participating interest under the JOA and/or the Oil Mining Lease.

Decision - Contempt of Court

However, in January 2017, and three days after a further hearing at which the interim injunction was continued, a meeting of the Joint Operating Committee was held, during which the Joint Operating Committee passed various resolutions relating to operations in respect of the Development Wells. Pan Petroleum was not invited

to participate at the meeting, and was treated as being excluded from voting due to being in default for failing to pay the disputed cash call(s).

Pan Petroleum asserted that the passing of the resolutions amounted to a breach of the injunction and brought an action to hold the non-Defaulting Parties in contempt of Court.

At the hearing, there was some debate as to the precise wording of the interim injunction, and whether the resolutions passed at the January 2017 Operating Committee meeting approved the '*financial calls and budgets for work on or with those [Development Wells], rather than the approval of the work itself*'. However, the Commercial Court was quick to find that the non-Defaulting Parties had breached the terms of the interim injunction and were in contempt of Court.

Comment

In the current market, operators have found it more difficult to gain unanimity on approving work programmes and budgets, or extensions to work programmes and budgets. As such, cash calls appear to be more regularly unpaid or disputed than was the case in the past. Further, debates seem to abound concerning whether sums cash called are properly authorised by the joint venture under the JOA.

For any joint venture governed by JOAs following the AIPN Model Form (or the Oil and Gas UK Model Form), the obvious risk for a party that does not wish to pay a cash call is that the operator (or other participant) will exercise the remedies contained within the default provisions of the JOA, and as a 'Defaulting Party' it will be prevented from voting on future decisions and will eventually be excluded.

The AIPN Model Form Operating Agreement and Oil and Gas UK Model Form are structured so as to allow a Defaulting Party to be excluded swiftly, which allows the joint venture to continue operations in such a way as to ensure that the underlying obligations of the joint venture to third parties will be performed. The risk to the supposed non-Defaulting Parties is that any failure of the remedies mechanism to work in the time-periods envisaged risks gridlock and a failure of the joint venture's purpose, resulting in losses and liabilities for all parties.

Where London is the seat of arbitration, the Commercial Court has the power to grant interim injunctions in support of arbitration. In deciding whether to exercise its discretion to grant an interim injunction, the Commercial Court will consider: (i) whether there is a serious question to be tried; (ii) whether damages would be an adequate remedy; (iii) who the balance of convenience favours; and (iv) any special factors. In this regard, although the actual judgment where the interim injunction was granted is not available, the decision nevertheless shows that the Commercial Court is willing to intervene, at least for a short period, in order to preserve the *status quo*.

This could have significant impacts on the conduct of joint operations pending resolution of the dispute. For example, while the injunction might prevent the non-Defaulting Parties from exercising any remedies to compel the Defaulting Party to withdraw from the joint venture, if the terms of the injunction are wide enough, or are otherwise interpreted broadly, the joint venture could conceivably be prevented from carrying out any further operations which are the subject of the dispute.

It is understood that this case is on appeal.

Judge: Knowles J.

Transportation and Change in Tariff Law

In *PT Transportasi Gas Indonesia v Conocophillips (Grissik) Ltd & Anor* [2016] EWHC 2834 (Comm) the Commercial Court upheld an arbitral award for damages, for a change to tariff regime, impacting a gas pipeline transportation agreement in Indonesia.

This decision highlights the inherent risk oil and gas companies face doing business abroad and agreeing that local laws will govern that business. It also provides a good example of how this risk can be mitigated through active drafting to ensure that any changes enforced by local law require appropriate recompense so as to maintain the sanctity of the contract.

Facts

PT Transportasi Gas Indonesia ('**TGI**') owns and operates the 'Grissik-Singapore pipeline', which stretches through Indonesia. ConocoPhillips (Grissik) Ltd and PetroChina International Jabung Ltd (together referred to as '**Conoco**') were shippers of gas. Conoco and TGI entered into a Gas Transportation Agreement (the '**GTA**') to transport gas through the pipeline (from fields in Indonesia to the Singaporean market). The original price for the transportation of gas was set, pursuant to the GTA, at US$0.69/mscf. Notably, the GTA was governed by Indonesian law.

Following execution of the GTA, a new oil and gas law came into effect in Indonesia providing that BPH Migas (the downstream regulator of the oil and gas industry in Indonesia) was to regulate and stipulate the tariff payable for the transportation of gas through gas pipelines in Indonesia. Further to this law, BPH Migas issued a decree in 2005 fixing the tariff applicable to the Grissik-Singapore pipeline at a level that corresponded to the contractual tariff.

In 2009, TGI made an application to BPH Migas for the tariff to be increased to account for (amongst other things) additional operating, maintenance and capital costs. TGI also attended seventeen private meetings with BPH Migas. In 2010, BPH Migas issued a decree increasing the tariff payable for the transportation of gas in the Grissik-Singapore pipeline from the contractually set tariff of US$0.69/mscf to US$0.74/mscf (the '**Decree**').

The Arbitration

Conoco commenced an UNCITRAL arbitration (seated in London) to dispute the increased tariff. Conoco argued that the increase was in breach of the contractual tariff provisions in the GTA. TGI, on the other hand, argued that the change in law meant that the tariff payable '*was no longer a matter of private negotiation between the parties*'. The Decree effectively overrode the tariff agreement.

The arbitral tribunal noted that the parties had agreed to adopt Indonesian law to govern the GTA, '*without reservation*' and that the Decree formed part of Indonesian law. Therefore, the tribunal decided that the increased tariff applied and there was no breach of the contractual tariff provisions in the GTA. The presence of a 'no amendment' clause (stating that the contract could not be amended except by way of written agreement between the parties) did not affect this position.

The arbitral tribunal pointed out that the GTA included a promissory warranty that the performance of TGI's obligations under the GTA would not violate any law or regulation. By applying the increased tariff, TGI had avoided breaking this warranty.

However, the arbitral tribunal then found TGI to have breached a number of other obligations, including the following:

— TGI represented, warranted and undertook to Conoco that the GTA (i) constituted legal, valid, binding and enforceable obligations; and (ii) contained no provision which is contrary to Indonesian law or which would not be upheld by the Indonesian Courts (Article 21.1(d)). Article 21.5(a) stated that this would remain true, accurate and in force throughout the term of the GTA. The arbitral tribunal concluded that as the Decree displaced the contractual provisions in relation to tariffs under the GTA, these provisions were no longer legal, valid and binding provisions. TGI was therefore in breach of the promissory warranty in Article 21.1(d).

— TGI undertook '*to obtain, maintain and comply with…all applicable laws and regulations as are necessary to enable [TGI] to fulfil in all material respects its obligations under [the GTA] throughout the term thereof and to enforce the same in good faith to the extent necessary to comply with its obligations under [the GTA]*' (Article 21.1(a)). The arbitral tribunal held that, by applying to BPH Migas to increase the tariff, TGI did exactly the opposite.

— Indonesian law imposed on TGI a duty to act in good faith in performing the GTA. Based on the above, the arbitral tribunal found TGI not to have done so.

TGI argued that having to pay damages for the above breaches would be contrary to Indonesian public policy that TGI should achieve a particular annual rate of return. This argument was rejected by the arbitral tribunal, which found no evidence of any such public policy and instead considered '*the sanctity and enforceability of contracts*' a public policy.

Damages of US$74 million were awarded to Conoco. Notwithstanding the finding that the increased, regulated tariff was valid, the arbitral tribunal calculated the damages so that its effect was to put Conoco into the same position as if the contractual tariff applied.

Challenge to the Arbitral Award

The award became public as TGI challenged the arbitral award before the English Courts on a number of grounds set out in section 68 of the Arbitration Act 1996 (the '**Act**'), namely that (i) the arbitral tribunal failed to comply with section 33 of the Act in determining the dispute on the basis of an issue that neither party had raised nor had an opportunity to address – section 68(2)(a) of the Act; (ii) the arbitral tribunal exceeded its powers by issuing an award which is contrary to Indonesian law – section 68(2)(b) of the Act; (iii) the arbitral tribunal failed to deal with an issue put to it - section 68(2)(d) of the Act; and (iv) the Award is contrary to public policy - section 68(2)(g) of the Act.

Decision

The Commercial Court dismissed TGI's challenge.

The Commercial Court was not sympathetic. The decision states that it was '*difficult to understand how [the first] ground could ever have been put forward*', that the second *forward', that the third ground 'was doomed to fail from the outset'*, and that the fourth and final ground provided '*no basis*' for setting aside the arbitral award.

While the judgment is a useful reminder of how difficult it is to raise a challenge under section 68 of the Act, what happened in the underlying arbitration is perhaps of greater interest to oil and gas lawyers.

Comment

This case will be of direct relevance to oil and gas companies operating internationally. Where there is freedom to agree the governing law of a contract, caution should be adopted in electing the local law of one party where the local state might have an interest in altering the underlying performance obligations of one party.

Where it is necessary to adopt the local law, it may be possible to take mitigating measures to protect against interference by local governmental agencies. The provisions adopted in the GTA are a good example of such measures.

Other common measures include: limiting the choice of law by stating that local law shall apply '*so far as it is consistent with principles of international law*' and change of law clauses. However, it is doubtful that those measures would be as effective as the specific measures in the GTA for circumstances such as a regulated change in tariff arrangements. This case is therefore a good reminder of how drafters can mitigate local political risk through specific and thoughtful contract drafting at an early stage of the relationship.

Judge: Cooke J.

Environmental liabilities and class actions

Environmental considerations rightly remain 'front and centre' of oil and gas operations. Such considerations are an important element of guidance sought by board members and senior managers. In the past twelve months the English Courts have decided issues concerning the proper corporate entity that may be sued in tort for environmental damage and delivered judgment on increased fines for environmental damage in the United Kingdom.

— In *His Royal Highness Emere Godwin Bebe Okpabi and Others v Royal Dutch Shell PLC and Shell Petroleum Development Company of Nigeria* [2017] EWHC 89 (TCC), the Technology and Construction Court refused to countenance a tortious claim against an ultimate parent company.

— In *R v Thames Water*, the Crown Court fined Thames Water in excess of £20 million under the Environmental Offences Definitive Guidelines for sentencing.

In defence of corporate structure

In *His Royal Highness Emere Godwin Bebe Okpabi and Others v Royal Dutch Shell PLC ('**RDS**') and Shell Petroleum Development Company of Nigeria* ('**SPDC**') [2017] EWHC 89 (TCC), the Technology and Construction Court confirmed that the English Courts will not permit tortious claims against the ultimate parent of an oil and gas company for the autonomous acts of their subsidiaries. The decision is a useful reminder on the importance of ensuring that an oil and gas group acts through the correct corporate entity when dealing with environmental issues that might give rise to claims in tort being made against it.

This decision may come as a relief to large groups of companies, which often contain multitudinous operating entities in a range of jurisdictions. The decision also highlighted, however, that the Court will adopt a case-by-case approach to the issue of the tortious liability of parent companies for the actions of a subsidiary.

Facts

Members of the Ogale community in Nigeria raised claims for damages against RDS and SPDC, alleging serious ongoing pollution and environmental damage caused by oil spills from the defendants' pipelines. SPDC was the operator of a joint venture with the Nigeria National Petroleum Corporation and two other Nigerian companies. RDS was the ultimate parent company of SPDC, and held shares in another company that held shares in SPDC.

Members of the Ogale community in Nigeria argued that the claims would have better prospects of being progressed, and substantive justice achieved, if undertaken in England. However, this would require a defendant to be domiciled in England. SPDC was domiciled in Nigeria; RDS, meanwhile, was domiciled in England. To seek to achieve their aim of having the case heard before the English Courts, the members of the Ogale community therefore sought to use RDS as an 'anchor defendant'.

By way of explanation, Practice Direction 6B allows for a '*necessary or proper party*' gateway to service in paragraph 3.1(3). A claimant may serve a claim form out of the jurisdiction (in this case on the Nigerian entity, SPDC) with the permission of the Court, where a claim is also made against another defendant (in this case RDS) and that claim form is served within the jurisdiction.

To make use of an 'anchor defendant' within the jurisdiction, however, a claimant also has to demonstrate that there is 'a real issue' between the claimant and that 'anchor defendant', and that it is an issue *'which it is reasonable for the Court to try'*. In other words, only if the members of the Ogale community could satisfy this test concerning RDS could they bring an action against SPDC in England.

Was there a 'real issue' to try against RDS?
The Technology and Construction Court proceeded by considering the strength of the case against RDS, the proposed anchor defendant.

Notably, the Claimants attempted to apply by analogy two previous cases: the first concerning another claim against SPDC (where it had agreed voluntarily to submit to English jurisdiction), the second concerning litigation against Vedanta. The Technology and Construction Court found, however, that the correct approach was not to '*slavishly*' follow past decisions, but to apply existing principles of law to the facts of the present claims.

The Technology and Construction Court considered whether RDS owed the Claimants a duty of care under English law (it was agreed that, for all relevant purposes, English and Nigerian law were the same on this point) by applying the three-fold test in *Caparo v Dickman* [1990] 2 AC 605 (listed below):

— Damage should be reasonably foreseeable;

— There should be a relationship of proximity or neighbourhood; and

— It should be '*fair, just and reasonable*' to impose a duty of care,

(the '**Caparo test**').

The Claimants relied on public statements made by RDS, including statements in its corporate literature, to argue that the Caparo test was satisfied and show that RDS held ultimate responsibility over SPDC's operations in Nigeria. Further, the claimants sought to show that RDS exercised sufficient control over its subsidiaries' affairs by reference to the RDS Executive Committee; as the Executive Committee was the central decision-making body of the Shell Group, RDS was responsible for the actions of SPDC by virtue of SPDC's membership in the Shell Group.

RDS, however, argued that where it had no employees, did not engage in any operations, provide any services, own any oil-producing assets, or have any licences to carry out operational activities, there could be no relationship between the Claimants and RDS giving rise to a duty of care.

Decision

The Technology and Construction Court found that the second and third limbs of the Caparo test had not been satisfied. RDS did not have a sufficiently close relationship with the Claimants to give rise to a duty of care, and to impose such a wide duty on RDS would be unfair. Generally, a company will not be liable for the actions of others simply by reason of common membership of a group. Instead, the existence of a duty of care depends on the circumstances of the case.

In considering the issue of proximity, the Technology and Construction Court noted the decision in *Chandler v Cape Plc* [2012] EWCA Civ 525. Merely holding shares in a subsidiary '*as if it were an investment holding company*' will not, by itself, give rise to a duty of care. Although there may be circumstances where a duty of care could arise, they did not apply in this case where:

- RDS was not operating the same business as SPDC, it was simply the ultimate holding company and its only business was holding shares in SPDC. It did not have any operations or infrastructure of its own in Nigeria.
- RDS did not have any superior, comprehensive, or specialist knowledge in comparison to SPDC, nor could it be expected to have such knowledge.
- RDS was not expected to hold an in-depth knowledge of SPDC's system of work; as a holding company, it could only be said to have a superficial overview.
- RDS was not being relied upon by SPDC to protect the claimants; SPDC was an autonomous subsidiary conducting operations in Nigeria.

In relation to public statements made by RDS, the Technology and Construction Court found that the statements had been made in relation to the Shell Group generally, and did not weigh heavily when considering whether a duty of care existed. Policies merely starting with '*all Shell companies must*' were insufficient to prove a duty of care.

Although having some sympathy for the situation of the Claimants, the Technology and Construction Court found generally that the evidence relied upon to found a claim against RDS was too thin or non-existent. There was no real issue between the Claimants and RDS which The Technology and Construction Court should try. In the absence of RDS as an 'anchor defendant', the claims against SPDC could not otherwise proceed in the English Courts.

Comment

The outcome of this case is positive for large international oil and gas companies. Although such companies may be perceived to have 'deeper pockets' to meet claims for negligence by an operating subsidiary, and the English Courts may be the preferred forum, liability in tort will ultimately turn on the traditional Caparo test of foreseeability, proximity, and reasonableness. The perceived vulnerability of the other party could not, by itself, justify making the parent company liable.

However, the decision should be treated with some caution. While in this case the Technology and Construction Court found that the claims should proceed against the operating subsidiary in Nigeria, much will turn on the company structure and relevant operational nexus in each case. It also flags the potential implications of other members of a corporate group being involved in operational issues that might give rise to claims in tort from third parties. This will be an important factor for companies to consider when assessing the most suitable structure for exploration and production operations in future. It also flags the potential implications of other members of a corporate group being involved in operational issues that might give rise to claims in tort from third parties.

Judge: Fraser J.

Environment: £20 million fine and costs

On 2 February 2017 Thames Water Utilities Limited ('**Thames Water**') was warned by a Crown Court Judge, when considering sentencing for water-related environment offences that '*The fine is going to be very substantial and the shareholders have got to get the message…*'.

Subsequently, the Court imposed a fine and costs order of £20,361,260.06 on Thames Water in respect of 14 offences with several other offences taken into consideration. This is the largest penalty following an environment prosecution since the introduction in England and Wales of sentencing guidelines, known as the Definitive Guideline for Environmental Offences (the '**Guideline**'), in July 2014 and the oil and gas sector would be wise to take heed of the consistent trend towards higher fines for environmental offences. Details of the offences and the fine are outlined below.

Facts

The prosecutions relate to the discharge into the River Thames of untreated sewage from four sewage treatment works ('**STWs**'), at Aylesbury, Didcot, Henley and Little Marlow and a large sewage pumping station at Littlemore. There was also one charge of pollution to land (with respect to the Little Marlow STW). On 17

March 2017 a further charge was added regarding a discharge from an unmanned sewage treatment plant at Arborfield with several other offences identified to be taken into consideration by the Judge in sentencing. The offences, in respect of which guilty pleas were entered, took place between January 2013 and June 2014. It has been reported in the media that the incidents caused the death of hundreds of birds and fish, impacted livestock and commercially affected businesses.

Decision

The Guideline sets out the approach which the Courts must follow when sentencing for certain environmental offences based on a matrix including the size of organisation (determined by turnover), the level of harm caused and the level of culpability involved. The 2016 Annual Review (page 52) explains the approach to '*very large organisations*', which Thames Water has been classified as previously. Where a very large organisation is involved, the Court can go outside the sentencing ranges where it is necessary to achieve a proportionate sentence.

The amount payable of £20,361,260.06 comprised:

Fines for:

- Failing to comply with/contravening the requirements of an environmental permit on 16 May 2013 - fine £1 million;
- Failing to comply / contravening the requirements of an environmental permit condition on 7 July 2013 – fine £9 million;
- Causing a water discharge activity on 18 April 2013 – fine £800,000;
- Failing to comply with / contravening the requirements of an environmental permit condition between 8 and 11 April 2013 – £800,000;
- Contravening the requirement of an environmental permit between 15 November 2012 and 31 December 2013 and failing to comply with / contravening the requirements of an environmental permit condition on between 1 January 2013 and 1 November 2013 – £8 million;
- Causing a water discharge activity on 29 December 2013 – fine £150,000; and
- Prosecution costs of £611,140.06 and a victim surcharge (required by legislation) of £120.

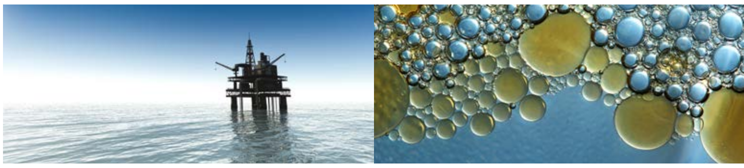
Comments

The sentencing remarks should be of interest to all senior management and investors in organisations including those in the oil and gas sector. At earlier hearings the Court was at pains to make clear that the message of sentencing was to ensure that shareholders take environmental obligations seriously (and via management of organisations ensure their implementation) and the costs of any fine should not be passed on to consumers. Of course the fines *per se* will not be insured. The resulting financial penalty of over £20 million is well placed to secure shareholder attention of not only Thames Water but also of other companies.

It is relatively clear from this and other recent sentencing decisions that the lower Courts share the view that fines for environment offences generally have been too lenient. From the Court's reported commentary in this case and in other recent cases we are seeing, the lower Courts are taking on board the message that the level of fine should be high enough so that boards of companies and their shareholders will take notice. It remains to be seen how much further than a £20 million fine the Courts will go in practice. At least in theory the Court of Appeal has stated that a fine could be equivalent to '*100% of a company's pre-tax net profits*'.

*Sentencing remarks reported in various sources including The Wandsworth Guardian and BBC News

Judge: Francis Sheridan J.



On-Demand Securities

In last year's Annual Review we commented on a toughening of approach by the English Courts to challenges made to calls under on-demand securities. This trend has continued with two cases on the 'fraud exception' to the enforcement of calls reaching the Court of Appeal.

— In *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2017] EWCA Civ 9, the Court of Appeal decided an oil contractor was entitled to call under an on-demand bond where the sum claimed was due and payable immediately, but there was a local legal restriction on payment being made.

— In *National Infrastructure Development Co Ltd v Banco Santander SA* [2017] EWCA Civ 27, the Court of Appeal refused to allow ongoing insolvency proceedings in Brazil to restrain payment under a standby letter of credit, even where the Brazilian Courts had required no payment to be made.

'Obligated to pay' under an oil rig contract

In *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2017] EWCA Civ 9 the Court of Appeal overturned the Commercial Court and decided that an oil contractor was entitled to call under an on-demand bond where the sum claimed was due and payable immediately, but there may be some restriction on the discharge of the debt or the debtor may have a good excuse for not discharging it due to local law.

The decision is a useful insight into the relationship between on-demand securities, payment obligations and the impact of local laws that may interfere in the underlying payment mechanism or obligation guaranteed.

Facts

PDVSA Servicios SA ('**PDVSA**') is a subsidiary of Petroleos de Venezuela SA, a corporation wholly owned by the Government of Venezuela and responsible for the development of hydrocarbons in the country. In 2010, PDVSA entered into a seven-year oil drilling contract with Petrosaudi Oil Services (Venezuela) Ltd ('**POS**') governed by Venezuelan law. Under the contract, POS was to provide oil rig drilling services to PDVSA and a drilling vessel.

POS was entitled to render invoices under the contract for services provided. Invoices were payable within 30 days and would be deemed to be accepted in full if PDVSA did not notify a dispute within 15 days of receipt (the '**Time Bar Provision**'). If a dispute was notified, PDVSA was required to make payment in full within the 30-day period, subject to repayment by POS of any amounts subsequently agreed or proved not to have been due in an arbitration under the contract (the '**Pay-Now-Argue-Later Provision**').

PDVSA also furnished a standby letter of credit ('**SLC**') to POS issued by Banco Espirito Santo SA and later transferred to Novo Banco SA (the '**Bank**'). The SLC was for an amount of US$130 million and was expressed to secure payment under the drilling contract. Among other things, the SLC required any demand made by POS to certify that PDVSA was '*obligated to* [POS] *to pay the amount demanded under the drilling contract*'.

Since January 2015, invoices issued by POS under the drilling contract had not been paid by PDVSA due to a dispute about the appropriate rate to be charged. POS had claimed the '*operating*' or '*standby*' rate whereas PDVSA contended that the much lower '*repair*' rate was applicable. The dispute was referred to arbitration and various interim orders were made limiting the recourse POS could have to the SLC (certain demands were permitted for invoices prior to November 2015, with the proceeds to be held by POS's solicitors but with POS being entitled to access some of the funds on a monthly basis to defray operating expenses).

Aside from the principle issue between the parties as to the appropriate rate, issues also arose as to the enforceability of the Time Bar Provision and the Pay-Now-Argue-Later Provision. PDVSA relied upon a provision of Venezuelan law ('**Article 141**') applicable to the drilling contract which required certain conditions to be fulfilled before payment was permitted to be made by PDVSA (such as verification that the services supplied complied with the contract and the authorisation of payment by a competent person). PDVSA argued that Article 141 was incompatible with the Time Bar Provision and the Pay-Now-Argue-Later Provision.

In two partial awards, the arbitrators held that that the Time Bar Provision and the Pay-Now-Argue-Later Provision were inconsistent with Article 141 and therefore null and void. Article 141 laid down a mandatory requirement that a Venezuelan State entity should ascertain that invoices for services rendered were correct before paying them. Any provision of a State contract which required payment to be made without Article 141 being complied with was void. This did not, however, affect POS's ability to obtain an arbitral award for the amount of any payment properly due under the drilling contract.

By the time the second partial award was released, the arbitrators had already cancelled some of their previous orders limiting POS's recourse to the SLC. Upon the release of the second partial award, the remaining limitations were cancelled and the arbitrators refused to grant a fresh injunction preventing POS from seeking payment under the SLC. As the SLC had an English law and jurisdiction clause, it was more appropriate for the English Courts to determine whether any such injunction should be granted.

Three days after the second partial award, POS demanded payment under the SLC for the full amount of US$130 million (the bond had been replenished by this point). As required by the SLC, the demand made by POS certified that PDVSA was '*obligated to* [POS] … *to pay the amount demanded under the drilling contract*'.

Commercial Court Decision

PDVSA was initially successful in obtaining an injunction from the English Commercial Court on the basis that POS's demand was made fraudulently. PDVSA argued that in light of the partial awards made by the arbitrators and the effect of Article 141, it was clear that no amount could presently be said to be payable by PDVSA. The Article 141 requirements had not yet been fulfilled in relation to the invoices relied upon by POS. Any contractual provision requiring earlier payment was therefore void and no payment could be said to be due until an arbitral award was obtained requiring payment. All of this was well known to POS and its certification that PDVSA was '*obligated*' to pay had, so PDVSA argued, been made fraudulently.

POS's demand had been signed by its general counsel, Mr Buckland, who was a solicitor qualified to practise in New Zealand and England and Wales. He gave evidence setting out the legal reasoning as to why he believed that PDVSA was obligated to pay POS's invoices, despite the effect of Article 141. He explained his view that a '*debt arises upon the performance of the services under the terms of the Contract*' and that Article 141 did not affect PDVSA's '*obligation*' but simply required '*PDVSA to carry out certain steps before they discharge their pre-existing obligation to pay*'.

In cross-examination, Mr Buckland agreed that he could not have certified that PDVSA was '*obligated to pay now*' if that is what the words '*obligated to pay*' meant, but he claimed not to have considered the '*temporal*' aspect of the issue at all when signing the demand. Instead, he had looked at what was due essentially in the abstract.

Applying the fraud exception, the Commercial Court first considered whether Mr Buckland's interpretation of the phrase 'obligated to pay' was correct. The Commercial Court found that the effect of Article 141 meant that there was no debt due '*in any real sense at all*' prior to the completion of the Article 141 requirements or an award by the arbitrators. The effect of the arbitrator's decision in his view meant that there was not in any real legal sense an obligation on PDVSA to pay any of the disputed invoices in those circumstances.

The Commercial Court then needed to consider whether Mr Buckland's view, although wrong about the law (as the judge thought), was nonetheless a view honestly held by Mr Buckland. Only if Mr Buckland had been dishonest in reaching this view would the fraud exception apply. The Commercial Court concluded that Mr Buckland had been dishonest and placed particular emphasis on the fact that the '*temporal*' argument that PDVSA needed to be '*obligated now*' to pay the amount demand was said not to have even been considered by Mr Buckland despite his familiarity with the arbitration proceedings and his taking advice on the demand. The Commercial Court conclusion was that Mr Buckland had essentially constructed a legal argument to suit POS's purposes:

> *'… because he thought that an interpretation could be placed on the word 'obligated' which could somehow stand or be argued to stand with what the obvious effect of the FPA and SPA was, i.e. that no sum was presently due. But I do not believe that he actually and honestly believed it to be the real meaning of the certificate, (which is in fact what was due now), and I reject his evidence to the contrary.'*

The fraud exception was therefore engaged and the Bank was restrained from paying out under the SLC. POS was also ordered to write to the Bank withdrawing its demands under the SLC. POS appealed.

Court of Appeal Decision

The Commercial Court's conclusion was overturned on appeal. The appeal was upheld principally on the basis that the legal view taken by Mr Buckland was in fact the correct one. The Court of Appeal noted that there was nothing contrived about recognising different types of debt obligation. A debt could be wholly contingent in that it only arises and comes into existence on the happening of a certain event; or it can be due but not payable for a certain period or until an event occurs; or it can be due and payable immediately but there may be some restriction on the discharge of the debt or the debtor may have a good excuse for not discharging it. The Court of Appeal concluded that the effect of Article 141 was to put this case into the latter category. In the Court's opinion Article 141, '*provided PDVSA with a form of legal excuse for non-fulfilment of its existing obligation to pay*'.

This conclusion was supported by the fact that the ability of the arbitrators to make an award requiring payment presupposed that the invoices in question were due and payable. The same applied to the right of interest and suspension for non-payment provided for by the drilling contract. These provisions suggested that PDVSA had an obligation to pay the invoices even if that obligation could not immediately be enforced, short of arbitration, due to Article 141.

The Court of Appeal noted that the expression '*obligated to pay*' used by the SLC was capable of more than one meaning and could refer either to the accrual of a liability to pay (as POS contended) or an obligation to pay which is immediately to be discharged (as PDVSA contended). However, in the Court of Appeal's view, the broader view which POS contended for was more consistent with commercial good sense and ought to be preferred. Venezuela generally and PDVSA specifically had a poor history of prompt payment and a contractor such as POS needed an assured source of regular payment over the course of a long-term drilling contract. The fact that Article 141 would prevent POS from being able to enforce regular payments explained why an SLC not subject to the Article 141 conditions was needed. The fact that the SLC referred specifically to the passing of 30 days since the receipt of invoices from PDVSA was also relevant, in comparison with the absence of any reference to an arbitration award.

The Court of Appeal's conclusions in this regard were sufficient to uphold the appeal, however it also noted some discomfort with the Commercial Court's finding of fraud against Mr Buckland:

> *'I wish, however, to express some disquiet at the finding of the judge that, on the view that he took of the legal position, Mr Buckland was fraudulent in signing the certificate. Whilst there is only one true construction of an instrument such as the certificate, different legal minds may obviously take different views on such a question. Had it been necessary to do so I would wish to have given anxious consideration to the question whether, despite the well-recognised advantages of a trial judge and the inhibition rightly felt by this Court in overturning findings of fact, the judge was entitled to conclude that Mr Buckland was fraudulent (i.e. conscious of the falsity of what he was saying or with no honest belief in, or a reckless indifference to, its truth) in holding the view that I currently hold, when making what was, in essence, a representation of law.'*

Judges: Lewison LJ, Christopher Clarke LJ.

Termination and insolvency

In *National Infrastructure Development Co Ltd v Banco Santander SA* [2017] EWCA Civ 27 the Court of Appeal refused to allow ongoing insolvency proceedings in Brazil to restrain payment under a standby letter of credit, even where the Brazilian Courts had required no payment to be made.

The case shows how standby letters of credit governed by English law, and the jurisdiction of the English Courts, can play an important role in protecting the innocent party in the event of underperformance and insolvency.

Facts

National Infrastructure Development Co Ltd ('**NIDCO**'), a government-owned corporation, entered into a contract with a Brazilian contractor, OAS Construtora ('**OAS**'), for the construction of a large highways project in Trinidad and Tobago. A number of Standby Letters of Credit ('**SLCs**') were procured by OAS to secure its performance under the contract and the repayment of an advanced payment.

OAS entered insolvency proceedings in Brazil and its contract with NIDCO was terminated. NIDCO made demands under the SLCs, including those provided by Banco Santander SA ('**Santander**'), to secure the repayment of retention money. The demands were in the form stipulated by the SLCs which required NIDCO to state that the amount demanded '*is due and owing to us by the Contractor*'.

Santander did not pay out on the demands because a Brazilian Court had issued an injunction to the apparent effect that the SLCs should not be honoured – and Santander would be exposed to penalties if it breached that injunction. However, the SLCs were subject to English law and the jurisdiction of the English Courts. NIDCO therefore brought proceedings against Santander in England and applied for summary judgment.

Santander relied on the fraud exception and claimed that NIDCO did not have an honest belief that the amounts demanded were '*due and owing*' to it by OAS. Santander argued that:

- The SLCs required more than a mere statement that a breach of contract had occurred and/or that loss had been suffered as a result. The amounts demanded were required to be '*due and owing*'.
- NIDCO's claim against OAS was one for damages, which pursuant to the law of Trinidad and Tobago would not become '*due and owing*' until liquidated by an arbitration award under the construction contract.
- Correspondence prior to the demands showed that NIDCO's claim against OAS was based on estimated amounts for future sums.
- Santander contended that previous payment certificates showed that a maximum of US$31 million in retention money could be claimed by NIDCO, whereas the total it had claimed under all of the SLCs provided as retention security (by Santander and other banks) was US$35 million.

Santander argued that the above facts were sufficient to put the honesty of NIDCO's demands in issue and to require a full trial with cross-examination of those responsible for the demands within NIDCO.
Santander separately argued that English law should be developed to recognise a different approach to on-demand securities used to secure performance obligations, such as in construction contracts, from those used to secure primary payment obligations, as in contracts for the sale of goods. It suggested that there should be an exception for unconscionable conduct in such cases alongside the existing fraud exception (as is the case in other common law jurisdictions such as Singapore and Australia).

Commercial Court Decision

The Commercial Court disagreed that any of the matters advanced by Santander provided a justification for further investigating the honesty of NIDCO's demands. The fact that under the law of Trinidad and Tobago the amounts demanded might be shown not to have been '*due and owing*' at the date of the demand was not directly relevant to whether NIDCO honestly believed in the validity of its demands: '*what really matters is not the law of England, nor the law of Trinidad, but the belief of [NIDCO].*'

For similar reasons, the Commercial Court was not persuaded that the maximum retention sum of US$31 million alleged by Santander provided any basis to challenge the honesty of NIDCO's demands. The Commercial Court noted the broader context of

> '*what was happening in this case and … under the construction contract, and the future of the construction contract*'. NIDCO's belief was not to be treated as a '*function of the legal analysis urged by [Santander], save perhaps in the plainest case, of which this is not one.*'

Whilst noting support for an unconscionability exception in the Singaporean cases and in academic writings, the Commercial Court rejected the existence of any such exception in English law. The Commercial Court emphasised that '*standby letters of credit must work in accordance with their terms, and that includes working on time*'.

Court of Appeal Decision

Santander's appeal against the Commercial Court's decision was heard on an expedited basis and was decided two and a half months later. Whereas the Commercial Court had focused on whether Santander's legal analysis was sufficient to impugn NIDCO's honesty in making its demands under the SLCs, the Court of Appeal directly challenged the correctness of Santander's legal analysis.

The Court of Appeal disagreed as a matter of law with the contention that the requirement for a valid call to include a statement that the amounts claimed were '*due and owing*' did not allow NIDCO's unliquidated claims for damages arising from termination to be included in such a call. The underlying contract incorporated the standard FIDIC clause 4.2(d) which stated that performance securities were required not merely for failures to pay amounts due but also for '*circumstances which entitle the Employer to termination … irrespective of whether notice of termination has been given.*' This was important background information against which the SLCs were to be interpreted and showed that unliquidated claims for damages arising on termination were permissible.

NIDCO was also entitled to call for the full amount of the retention security even though this sum exceeded the amount of the cash retention which would have been held by NIDCO at the date of termination had the retention security not been provided in lieu of a cash retention. The Court of Appeal viewed the provision of a retention security in lieu of cash retention as being '*for the benefit of the contractor*' and any restriction on the Employer's ability to call on the full amount of the retention security needed to be expressly stated in the SLC.

NIDCO's calls were therefore valid in law and there could be no basis for impugning their honesty.

Comment

A number of conclusions can be drawn from these cases as to the ability of parties to make calls under on-demand securities in circumstances where legal uncertainty may exist as to their entitlement to do so:

— The *Petrosaudi* decision represents one of the only times in which the fraud exception has been successfully argued after a call has been made on an on-demand security. Although the decision was reversed on appeal, the case provides a lesson as to the use of legal advice when making such calls. Lawyers will tend to identify various interpretations of bonds or contracts which may be 'arguable' or 'plausible' but which they consider to be unlikely to succeed. Making a call on the faith of an 'arguable' or 'plausible' interpretation which is not thought

likely to succeed will be fraudulent. As the Commercial Court noted in *Petrosaudi: 'The fact that [Mr Buckland] may have thought that an argument or even a strong argument could be put forward to justify the [demand] by means of the different interpretation of 'obligated' is irrelevant. He himself had to believe in that different interpretation so as to render the certificate true …*'.

— A party may therefore be better off without obtaining legal advice as to the merits of a proposed call where a commercial view is already held that a call is justified. As shown by the NIDCO case, English law will be slow to conclude that a commercially held view is fraudulent merely because it is at odds with the legal position. In the Court's language, a party's state of mind (in the absence of legal advice) is not to be taken as a function of a particular legal analysis save in the clearest of cases.

— Care should be taken, however, not to avoid taking legal advice in respect of pre-existing doubts as to a party's ability to make a call. A deliberate decision not to investigate such doubts can also amount to fraud, sometimes referred to as recklessness or '*wilful blindness*' under English law. A better course, is for a written policy to be put in place in advance detailing the procedure for making calls under on-demand securities, including whether or not legal advice will be taken and in what respects, and covering other matters such as board authorisation, signatories and the like.

— The NIDCO decision provides an important precedent for parties wishing to call on on-demand securities after the termination of a contract. Difficulties can sometimes arise in such circumstances where the contract requires the party's entitlement to additional costs and/or compensation to be calculated after completion of the works by a replacement contractor or itself. On-demand securities will often be due to expire before completion in such circumstances, meaning that the party calling the bond may look to make a demand based on estimated losses. Depending on the drafting of the contract in question, a party may sometimes have no claim at all until the works are completed.

— In relation to drafting, it appears that provisions in the underlying guaranteed agreement(s), that require the performance securities, were required not merely for failures to pay amounts due but also for '*circumstances which entitle the Employer to termination … irrespective of whether notice of termination has been given*' will assist with the construction and interpretation of the security as applying to sums due upon termination events.

— Finally, English law remains opposed to any unconscionability exception for on-demand securities, unlike other common law jurisdictions such as Singapore and Australia and the many civil law jurisdictions which permit challenges to be made to calls which, although not fraudulent, may nonetheless be characterised as 'abusive'.

Judges: Longmore LJ, Christopher Clarke LJ.

Contractual termination and the common law right

In oil and gas contracts, parties usually include express termination rights. The exercise of such rights and the consequences that flow are a matter of contract. However, recent cases have considered the extent to which a 'material breach' termination clause may affect parallel rights to terminate at common law for repudiation. Such common law rights are easily overlooked, but will often be relevant in termination scenarios and can provide valuable rights in addition to those specified under the contract.

- In *C&S Associates UK Ltd v Enterprise Insurance Company* [2015] EWHC 3757 (Comm), the Commercial Court considered how a clause which permitted a party to terminate for 'material breach' was to be interpreted.
- In *Vinergy International (PVT) Ltd v Richmond Mercantile Limited FZC* [2016] EWHC 525 (Comm), the Commercial Court held that the respondent, was able to terminate an agreement for repudiatory breach without complying with the notice and remedy requirements in the contract's termination clauses.
- In *Obrascon Huarte Lain SA v Government of Gibraltar* [2014] EWHC 2291 (TCC), the Technology and Construction Court considered notice of default provisions and gave guidance on when a default notice may properly be used.

The effect of express termination clauses on common-law rights to terminate

Most oil and gas contracts will contain express rights of termination. These rights will usually be backed up by detailed provisions setting out each party's rights, obligations and liabilities following termination. Rarely, however, will the parties specify how these contractual provisions are to affect common law rights of termination arising under English law.

It is sometimes thought that the agreement of express termination provisions will displace common law rights of termination. However, this is rarely the case. English law requires clear words before such rights will be excluded. The mere fact that the parties have agreed their own termination provisions will usually not be sufficient.

The inclusion of express rights of termination may, however, have the effect of modifying common law rights. They may, for example, become subject to the same notification regime applicable to terminations under the express provisions. Common law rights of termination usually depend on the seriousness of a given breach of contract, and in this regard express termination provisions can provide a reference point for what the parties consider to be sufficiently serious to justify termination.

The availability of common law rights of termination can also have important consequences. They may allow a terminating party to access remedies not otherwise available under express termination provisions. For example, a common law right of termination could assist the innocent party by providing an immediate right to damages. Common law rights of termination might also be relied upon to support an otherwise invalid termination under express provisions.

Two recent cases have considered the extent to which clauses permitting termination for material breach impinge on common law rights of termination under English law. We consider these cases below together with the position arising under the standard LOGIC termination provisions.

In *C&S Associates UK Ltd v Enterprise Insurance Company* [2015] EWHC 3757 (Comm) the Commercial Court considered how a clause which permitted a party to terminate for 'material breach' was to be interpreted.

Facts

Enterprise Insurance Company ('**Enterprise**'), an insurance company, entered into a contract with C&S Associates UK Ltd ('**C&S**'), an insurance claims handler, for C&S to handle third-party motor claims on behalf of Enterprise.

Termination was dealt with at Clause 15 of the agreement, which required:

> *'15.1 This Agreement may be terminated at any time by either of the Parties giving at least three calendar months' notice in writing to the other.*
>
> *15.2 Either party ('the Aggrieved Party') may at any time terminate the Agreement forthwith by written notice to the other Party if any of the events referred to below occur in relation to the other Party, namely:*
>
> ** the other Party commits a material breach of any provision of this Agreement and (if such default is capable of remedy) it is not remedied within 30 days (or such longer notice as the Aggrieved Party may specify) after written notice shall have been given by the Aggrieved Party to the other Party requiring such remedy giving full particulars of the breach and the reasonable steps necessary to remedy it …'*

Upon termination the agreement required:

> *'16.1 Enterprise shall forthwith pay to C&S all sums due to C&S (including all sums which would have been payable at some future time, the due date for which shall become the date of termination);*
>
> *16.2 C&S shall forthwith pay to Enterprise all sums due to Enterprise (including all sums which would have been payable at some future time, the due date for which shall become the date of termination) and all unused amounts in the Claims Fund;*
>
> *16.3 C&S shall, unless Enterprise expressly does not require it, continue to handle all existing claims until they are concluded, and all of C&S's obligations and Enterprise's obligations under this Agreement shall continue insofar as they can apply to such claims. Should C&S handle existing claims, the fee will continue to be paid on settlement of individual cases, on production of the monthly bordereaux and fee invoices.*


16.4 If requested by Enterprise, C&S shall deliver all data and material belonging to Enterprise forthwith and C&S's authorised representative shall certify full compliance with this clause.

16.5 All provisions of this Agreement which are intended to have effect following any expiry or termination of this Agreement shall survive expiry or termination of this Agreement to the extent permissible by law.

16.6 C&S shall not handle any new claims after the termination date unless agreed otherwise by the Parties.'

The parties fell into dispute over the provision of the services and Enterprise requested that a large number of claim files be delivered to it for inspection. C&S refused this request, noting that it would prevent it from continuing to work on the files, but offered to allow Enterprise to inspect the files at its offices. Enterprise considered that this refusal amounted to a repudiation of the contract and sought to terminate at common law. If the Commercial Court found that C&S's refusal was not in breach of contract, Enterprise also argued that its termination was nonetheless justified by the overall poor quality of C&S's service up until that stage. This was also said to have amounted to a repudiation of the contract providing an alternative justification for Enterprise's termination. The quality issues were contested, and in addition C&S argued that Enterprise's right to termination for repudiation in such circumstances had been modified by a right to terminate for 'material breach' contained in the contract.

C&S argued that this Clause showed an intention that breaches which were capable of being remedied, such as the quality issues complained of by Enterprise, were not to be repudiatory unless the innocent party had first given a notice requiring those breaches to be remedied.

Decision

The Commercial Court drew the following conclusion from the authorities:

- It is open to parties to agree that certain breaches or kinds of breach are not to be treated as repudiatory. Such clauses will be effective.
- Although every case will depend on the particular contract in issue, examples where clauses have been held to have this effect include (a) clauses which provide that specified conduct gives rise to a right of termination but only after service of a notice or a period of time, and (b) clauses which provide compensation for certain kinds of poor performance.
- Where a contract does provide that certain breaches or kinds of breach are not to be treated as repudiatory, that may provide guidance as to whether other kinds of breach qualify or are capable of qualifying as repudiatory. For example, breaches which are less serious are unlikely to do so.
- However, a clause such as Clause 15.2 in the present case, providing for termination in the event of a material breach but only after the giving of a notice and a failure to remedy, will not by itself prevent a sufficiently serious breach from amounting to a repudiation of the contract justifying an immediate termination. Such a clause will generally provide for a right to terminate which is in addition to a party's common law rights.

It followed that it was open to Enterprise to make a claim for repudiatory breach. On the facts, the Commercial Court accepted that the individual breaches alleged by Enterprise were not serious enough to amount to a repudiation. The bad handling of any single individual claim is unlikely to have had sufficiently serious consequences to qualify as repudiatory. However, that did not mean that the cumulative effect of all the breaches relied on was not such as to deprive Enterprise of substantially the whole benefit of the contract, particularly if they reveal extensive systemic failings on the part of C&S. Accordingly the breaches of C&S's duties alleged by Enterprise were capable, if proved, of amounting to a repudiatory breach, and would require a trial on the facts.

Judge: Males J.

Material breach

In another recent case concerning the downstream petroleum industry, a similar result was reached in *Vinergy International (PVT) Ltd v Richmond Mercantile Limited FZC* [2016] EWHC 525 (Comm).

Facts

Vinergy International (PVT) Ltd ('**Vinergy**') was held by an arbitral tribunal to have repudiated a long-term bitumen master supply agreement ('**MSA**') by breaching an exclusivity clause. Vinergy's counter-party, Richmond Mercantile Limited FZC ('**Richmond**'), had therefore validly terminated the contract at common law. Vinergy appealed to the Commercial Court on a point of law pursuant to section 68 of the Arbitration Act 1996, arguing that Richmond had failed to comply with a clause in the contract requiring a cure period to be given prior to termination.

Clause 17 concerned termination and provided as follows:

> *'17.1 Either party may terminate this Agreement immediately upon:*
>
> *17.1.1 failure of the other party to observe any of the terms herein and to remedy the same where it is capable of being remedied within the period specified in the notice given by the aggrieved party to the party in default, calling for remedy, being a period not less than twenty (20) days; ….*
>
> *17.1.2 the other party suffering an Insolvency Event …….'*

Clause 18 concerned effect of termination and provided as follows:

> *'18.2 Termination of this Agreement, including but not limited to Termination in accordance with Clause 17, will not prejudice the rights of action or remedy of [Vinergy] or [Richmond] in respect of any antecedent breach by the other party of any of such party's obligations under this Agreement.'*

When Richmond terminated the MSA, Richmond did not give notice in accordance with Clause 17. It was argued on behalf of Vinergy that for that reason the termination was not lawful and was in fact a wrongful repudiation of the MSA. The arbitral tribunal did not accept this argument. The arbitral tribunal dealt with the point at paragraph 53 of its reasons:

> *'Richmond pleaded termination under Clause 17 as well as at common law but in their arguments before the Tribunal they placed the emphasis of their argument on the latter. It was clear that some of the claims, such as those for non-payment, were capable of remedy and the notice of termination on 20th July 2012 was premature given that the initial notice to remedy was served on 2nd July and Clause 17.1.1 requires the parties to give notice of not less than 20 days to remedy before termination. This is, however, of limited relevance since Richmond also have common law rights to terminate on the ground of a repudiatory breach and these rights (and rights in respect of antecedent breaches generally) are expressly preserved by Clause 18.2 of the MSA.'*

No appeal was possible from the arbitral tribunal's finding of fact that a repudiation had occurred and it was not therefore possible for Vinergy to pursue the point raised in the Enterprise decision as to whether this clause required a cure period to be allowed before conduct could be said to be repudiatory. However, Vinergy contended that the clause was to be interpreted as applying to repudiatory breaches so that the giving of a notice and cure period was a contractual requirement applicable to common law termination.

As a matter of interpretation, Vinergy's argument failed. The Commercial Court decided that:

- Clause 17.1.1 provides the parties to the MSA with an express right to terminate which is not dependent upon the other party having committed a repudiatory breach of the MSA.
- The express right arises on (i) the failure of the other party to observe any term of the MSA and (ii) the failure of the other party to remedy the breach within the period specified in the notice of the aggrieved party calling for remedy.
- There is nothing in Clause 17.1.1 which expressly refers to the right of a party to accept a repudiatory breach as terminating the MSA.
- The question is whether one can imply in Clause 17.1.1 an agreement that before a party terminates the MSA, whether pursuant to Clause 17.1.1 or pursuant to the common law, the party must follow the procedure laid down in Clause 17.1.1 of giving notice to remedy within a period of time not less than 20 days.
- In the Commercial Court's judgment one cannot imply such an agreement in Clause 17.1.1.
    - First, there is no mention in Clause 17.1.1 of the common law right to accept a repudiatory breach as terminating the MSA. The express right to terminate provided by Clause 17.1.1 is expressed to be dependent upon the '*failure … to observe any of the terms herein*'. Such a failure may be major or minor in terms of seriousness.
    - Second, Clause 17 as a whole provides 6 contractual rights to terminate of which Clause 17.1.1 is but one. The requirement to give notice to remedy in Clause 17.1.1 does not apply to the other 5. For example, it does not apply to the right to terminate in Clause 17.1.2 where one party suffers an Insolvency Event.
- Thus the agreement which can be inferred from Clause 17 is that the procedure in Clause 17.1.1 was intended to apply only to the specific right to terminate found in Clause 17.1.1 and not to any of the other express rights to terminate in Clause 17 or to the right at common law to accept a repudiatory breach as terminating the contract.
- Clause 18 dealt with the effect of termination and Clause 18.2 in particular made clear that however the MSA was terminated, rights of action in respect of any prior breach remained unaffected by the termination. That is consistent with the position at common law. Nothing in Clause 18 touched on the question whether notice of remedy was required before a party could accept a repudiatory breach as terminating the MSA.

The Commercial Court accepted that other cases had resolved in the common law right to terminate being restricted by an express termination clause. However, those authorities involved differently expressed terms and there is therefore an obvious limit to the assistance they can give in this case.

The appeal was, therefore, dismissed.

Comment

Lewison on the Interpretation of Contracts (6th Edition, paragraph 17.16) expresses the learned view that where '*a contract contains termination provisions they will not usually preclude termination at common law*'. However, in drafting or seeking to exercise 'termination rights' it is important to keep in mind the relationship between common law acceptance of a repudiatory breach and contractual termination.

As a matter of construction of contract, it might be that common law acceptance of a repudiatory breach and contractual termination are one and the same. If this is the case, a termination of contract will likely entitle the innocent party to common law damages and the right to accept a repudiatory breach will be limited by any relevant termination mechanism in the contract. Alternatively, if the common law acceptance of a repudiatory breach and contractual termination remain separate and distinct, acceptance of a repudiatory breach might not be limited by the termination provisions and damages might not be available for a contractual termination.

In *Lockland Builders v. Rickwood* (1995) 46 Con LR 92 (CA), a clause in a building contract gave the owner a right to terminate for delay of poor materials if he served a notice of breach and complied with the procedure set out in the contract. The owner did not follow this procedure but sought to terminate for repudiatory breach. The Court of Appeal considered whether, had there been a repudiatory breach, there had to be a notice of breach in accordance with the clause. Russell LJ said at 98:

> *'My own view -- returning to the facts of the instant case -- is that cl 2 and the common law right to accept a repudiatory breach can exist side by side, but only in circumstances where the contractor displays a clear intention not to be bound by his contract, for example, by walking off the site long before completion (as suggested during the course of argument by Hirst LJ) or, by way of further illustration, failing to comply with plans in a very fundamental way, for example, by not building a third storey when contractually bound to do so. But such cases are far removed from the instant one. On the facts of this case, I, for my part, would be prepared to hold that cl 2 created the only effective way in which Mr Rickwood could determine this agreement. It is difficult to understand why the clause should be there at all if that were not the true position.'*

Hirst LJ said at 102:

> *'In my judgment, this cl 2 did impliedly preclude Mr Rickwood from terminating the contract on the facts of the present case otherwise than by the exercise of his rights under cl 2 since the complaints made fell squarely within the scope of cl 2, i.e. complaints as to the quality of materials and workmanship. However, cl 2 would not have done so in relation to breaches outside the ambit of cl 2, e.g. by Mr Ryan walking off the site when the works were still substantially incomplete.'*

Thus the Court of Appeal accepted that whilst the notice of breach was required in respect of breaches that fell within the scope of the clause in question, notice of breach would not have been required in respect of a repudiatory breach arising from the renunciation of obligations under a contract.

In the oil industry case of *Amoco v BAOL* (Unreported, 16 November 2001), Langley J held:

> *'The Contract itself contained its own scheme for compensating Amoco for reduced efficiency or performance by reduction in the operating rate for the period of the reduction in efficiency or performance (Appendix 10) and by a breakdown rate reduced to a nil rate after 48 hours. It also contained in Clause 28.1 its own provisions for termination which were effective after a breakdown of sufficient gravity to cause BAO to be unable to perform its obligations under the contract lasting 30 days or a major fault causing a suspension of operations for more than 30 days. Those provisions themselves must in my judgment form part of an appreciation of the benefit the parties were intended to derive from the contract. Thus circumstances otherwise within the scope of the termination provisions but falling short of the precise terms would in my judgment not give rise to the right to terminate at common law for the very reason that the parties agreed when and how such circumstances should have that consequence: see Lockland Builders Ltd v. Rickwood (1995) 46 Con LR 92 (CA). The provisions are ones for the benefit of both parties not just for the benefit of Amoco involving as they do time and notice constraints. For present purposes loosely expressed what I think that comes to is that to justify termination at common law something 'worse' or not addressed by those provisions would be required.'*

Lockland Builders v. Rickwood and *Amoco v BAOL* were considered by Ramsey J. in *BSkyB v HP Enterprise Services UK Ltd.* [2010] EWHC 86 (TCC) where there was also a notice provision in the event of a breach. Ramsey J. said:

> *'I do not read those decisions [Lockland Builders v Rickwood and Amoco v BAOL] as laying down any hard and fast rules. Rather, in deciding whether by its conduct a party evinces an intention not to be bound by the terms of the contract, the way in which parties agreed to treat breaches within the terms of their contract must be a factor to take into account. In particular, if a breach of a term had to reach a degree of seriousness before a contractual termination clause could be applied, it is unlikely that a breach which was less serious would, by itself, amount to a repudiatory breach. Equally, the fact that for a particular breach the contract provided that there should be a period of notice to remedy the breach would indicate that the breach without the notice would not, in itself, amount to a repudiatory breach.'*

As such, it is apparent that the relationship between common law 'termination' and contractual termination will depend upon the contract between the parties. In drafting termination provisions, careful thought should be given to such relationship. In addition, in operating termination provisions or seeking to accept a repudiatory breach, as bringing a contract to an end, careful consideration should be given as to (1) any contractual restrictions in relation to accepting a repudiatory breach or triggering contractual termination and (2) the potentially differing financial consequences of accepting a repudiatory breach and claiming contractual termination.

Judge: Teare J.

Termination after notice not the same as termination for 'any default'

In *Obrascon Huarte Lain SA v Government of Gibraltar* [2014] EWHC 2291 (TCC), the Technology and Construction Court decided that a contract containing a notice of default provision, which permitted a party to terminate for a failure to comply with the notice of default, allowed the Court to apply a lower standard to the severity to breaches needed for termination than if the clause had simply allowed termination for 'any default' without notice. The Technology and Construction Court also gave guidance to the parties on when a default notice may properly be issued.

Although only a first instance decision, the Technology and Construction Court's decision is of interest to participants in the oil and gas sector that use similar termination provisions. As the case related to a FIDIC Yellow Book contract, it also provides a useful illustration of how the Courts may interpret the termination provisions in the FIDIC Yellow Book (as defined below). These are slightly differently to those in certain LOGIC model form contracts, but contain some common characteristics.

Facts

The proceedings were between Obrascon Huarte Lain SA ('**OHL**'), a substantial Spanish civil engineering contractor, and the Government of Gibraltar ('**GOG**'), in relation to a contract for the design and construction of a road and tunnel under the eastern end of the runway of Gibraltar Airport.

After over 2½ years of work on the two-year project and when little more than 25% of the work had been done, the contract was terminated. Issues arose as to who was legally and factually responsible.

Subject to some relatively minor changes, the contract was (amongst other things) based on the FIDIC Conditions of Contract for Plant and Design-build for building and engineering works designed by the Contractor (1st Edition 1999), sometimes known as the FIDIC Yellow Book.

The termination clause at Clause 15.1 of the General Conditions of Contract required that:

> *'15.1 If the Contractor fails to carry out any obligation under the Contract, the Engineer may by notice require the Contractor to make good the failure and to remedy it within a specified reasonable time.*
>
> *15.2 The Employer shall be entitled to terminate the Contract if the Contractor:*
>
> *(a) fails to comply…with a notice under Sub-Clause 15.1…*
>
> *(b) …plainly demonstrates the intention not to continue performance of his obligations under the Contract,*
>
> …
>
> *In any of these events or circumstances, the Employer may, upon giving 14 days' notice to the Contractor, terminate the Contract and expel the Contractor from Site.'*

OHL argued that '*a contract contains a provision such as Clause 15.2 which entitles an employer to terminate by reason of a failure to remedy a breach of contract which* *has been the subject of a Clause 15.1 notice… the breach of contract that is relied upon must be serious and one which is analogous to a repudiatory breach of contract*'.

In support of its argument, reference was made to *Antaios Compania Naviera S.A. v Salen Rederierna A.B.* [1985] A.C. 191, where the House of Lords held that arbitrators were plainly right to have decided that a clause in a charterparty that provided that the owners were entitled to withdraw 'on any breach' only gave a right to withdraw where there was a repudiatory breach.

A breach will be repudiatory only if it is '*so grave as to go to the root of the contract*' and '*deprive[s] the party … of substantially the whole benefit*' of the contract. It follows that it will be in relatively rare circumstances where a party commits a repudiatory breach.

The question arose as to whether the defect notice provision in Clause 15.1, when taken together with the Clause 15.2(a) right to termination, meant that the Court was entitled to apply a different (lower) standard in deciding whether termination was permitted.

Decision

The Technology and Construction Court decided that it was entitled to apply a lower standard to the employer's right to terminate for failure to comply with a notice than the repudiatory breach. It further decided that GOG was entitled to terminate the contract.

In upholding GOG's right to terminate, the Technology and Construction Court decided a number of points that will be of interest to the oil and gas industry, where similar termination clauses can be used:

- One needs to consider each contract on its own terms. For instance, if the termination clause allows for termination 'for any breach of contract no matter how minor', the meaning is clear and would not require a repudiatory breach.
- The notice provision in Clause 15.1 relates only to more than insignificant contractual failures by the Contractor.
- The specified time for compliance with the Clause 15.1 notice must be reasonable in all the circumstances prevailing at the time of the notice. What is reasonable is fact sensitive.
- Clause 15.1 is designed to give the Contractor an opportunity and a right to correct its previous and identified contractual failure.
- Most of the cases, that found that 'any breach' meant any repudiatory breach, did not involve contracts like the contract in this case, which gives a list of grounds on which termination can take place, that includes one which is not unlike the test for English common law repudiation, namely Clause 15.2 (b) (where the Contractor '*plainly demonstrates the intention not to continue performance of his obligations under the Contract*'). The existence of Clause 15.2(b) might be said to indicate that Clause 15.1(a) governs something different to a repudiatory breach.
- The cases relied upon by OHL in this context had a relatively simple right to terminate (for a, or any, breach). The contract here at least for the Clause 15.2(a) basis (failure '*to comply…with a notice under Sub-Clause 15.1*') had a warning mechanism whereby termination could be avoided by the contractor's compliance with the Clause 15.1 notice. In that sense, the contractor is given the chance to avoid termination whilst the simple termination for any breach can come out of the blue. Commercial parties would sensibly understand that this contractual chance is also a warning to the contractor and the remedy is in its hands in that sense.

Comment

The Technology and Construction Court was clear that each contract and termination clause must be construed on its own terms. It is therefore important to avoid broad generalisations as to the meaning and effect of termination clauses (and contracts) of differing drafting.

In this case, the Technology and Construction Court decided that the contract entitled the employer to issue a default notice provided that the breach was not '*insignificant*' or '*trivial*'. If the contractor did not then remedy the defect in a reasonable time, the employer was entitled to terminate the contract. This seems to set the bar for termination significantly lower than material (repudiatory) breach.

In reaching this decision, the Technology and Construction Court appeared to place some weight on the fact that Clause 15.2(b) allowed termination where the Contractor '*plainly demonstrates the intention not to continue performance*' and suggested that giving an *Antaios* type meaning to the construction and interpretation of 15.1 and 15.2(a) might have the effect of robbing 15.2(b) of any meaning.

The decision also seems consistent with the approach that the *Antaios* was the high water mark of construing termination provisions such that 'any breach' or 'any default' will commonly be constructed as meaning repudiatory breach. The more modern approach is to differentiate between provisions that allow for 'hair trigger' termination for 'any breach' (which might mean repudiatory breach) and more sophisticated clauses that were seeking to do something different and a lower standard might be applicable.

Judge: Akenhead J.

UK Oil and Gas Industry Regulation round-up - the OGA – One year on

OGA – Status and Powers

1 October 2016 brought a seismic shift in the UK oil & gas industry's regulatory framework, when most of the relevant sections of the Energy Act 2016 came into force, transferring many of the Secretary of State's functions to the new regulator, the Oil & Gas Authority ('**OGA**').

Implementation of further powers has followed since, so that the OGA's powers now cover the following broad areas:

— **Licensing and regulation** (under the Petroleum Act 1998): including powers to award licences and consent to licence assignments;

— **Decommissioning** (under the Petroleum Act 1998): although BEIS still approves abandonment programmes, the OGA must be consulted before their submission to the Secretary of State for approval;

— **Tax:** certain powers relating to determination of oil fields and cluster areas for the purposes of assessing tax liability;

— **Dispute resolution** (under the Energy Act 2016): power to investigate 'qualifying' disputes and make non-binding dispute resolution recommendations for their resolution in the way that best contributes to fulfilling the MER UK Strategy;

— **Sanctions** (under the Energy Act 2016): the OGA may impose sanctions when parties do not comply with a 'petroleum related requirement' (a duty to act in accordance with the MER UK Strategy, a term or condition of an offshore licence or a requirement imposed on a person under the Energy Act). The sanctions available are: enforcement notices, financial penalties (of up to £1 million), licence revocation notices and operator removal notices;

— **Meetings** (under the Energy Act 2016): the OGA must be notified of and be given the opportunity to attend and participate in (although not vote at) certain categories of meetings as described in the OGA's 'Meetings: Statutory Notice', and issued in November 2016; and

— **Information & Samples** (under the Energy Act 2016): the OGA may require regulated parties to provide it with petroleum-related information or samples held by it or on its behalf (unless legally privileged).

MER UK Strategy

The goal of '*maximising economic recovery of UK petroleum*' ('**MER UK**') is the primary driving force behind the new regulatory regime. The Energy Act 2016 requires the preparation of strategies to enable the '*principal objective*' to be met. Consequently, the Secretary of State published the MER UK Strategy in March 2016. The Strategy defines the '*central obligation*', which requires relevant persons to take steps to ensure that the maximum value of economically recoverable petroleum is recovered. During the course of late 2016 and early 2017, the OGA has taken steps to flesh out what compliance with the MER UK Strategy looks like in terms of day-to-day activities.

Strategies and Delivery Plans

First, in September 2017, it published seven strategies: Asset Stewardship; Decommissioning; Exploration; Enhanced Oil Recovery; Information Management; Supply Chain; and Technology. All of these strategies (other than Exploration and Asset Stewardship) now also have accompanying Delivery Plans.

Asset Stewardship Strategy and Expectations

Separately, and perhaps most significantly, the OGA also produced its Asset Stewardship Expectations (the '**Expectations**'), and more detailed Implementation Guides (for all except SE-07 Information Management) to explain how they should be given effect in the day-to-day operation of an oil & gas business.

For the OGA, effective asset stewardship is crucial to achieving MER: it means '*asset owners consistently do the right things to identify and then exploit opportunities*' and '*assets are in the hands of those with the collective will, behaviours and capabilities to achieve this*'. The Expectations cover ten key areas: joint venture hub strategy; exploration and appraisal subsurface work programmes; optimum use of subsurface data; licence activity, decision points and milestones; robust project delivery; production optimisation; information management; technology plans; collaboration; and planning for decommissioning.

The Expectations are not legally binding but failure to meet them may be viewed as a failure to comply with the MER Strategy – of course that in turn brings the risk of OGA imposed sanctions.

The OGA has a greatly broader and more nuanced set of tools at its disposal than BEIS to push and pull the oil & gas industry in the UK towards achieving MER UK. During its initial months in full operation, the OGA appears to have preferred to encourage, persuade and cajole the industry to implement the detailed requirements that it considers necessary to reach that goal. But it is also now clear that the OGA will not hesitate to push (by way of sanctions if necessary) if companies do not willingly move far enough or fast in the right direction.

Collaboration and Competition

The importance of collaboration in achieving MER UK pre-dates the establishment of the OGA: it is a theme identified in the Wood Review, which continues to be seen by the OGA as a key area of focus. However, collaboration becomes complicated where the process or outcome risks are being deemed anti-competitive. The Competition and Markets Authority ('**CMA**') wrote to the Secretary of State for Energy and Climate Change in December 2015 underlining the need for the OGA to ensure that it did not, even inadvertently, encourage or facilitate breaches of competition law. The MER UK Strategy recognised that concern – the first Safeguard in the Strategy provides that no obligation imposed by or under MER UK permits or requires any conduct which would otherwise be prohibited by or under any legislation, and that must include competition law.

The OGA has taken various steps throughout its first year to try to assist industry in balancing real collaboration with the relevant competition rules.

In November last year, the OGA published its high-level review of '*Competition and Collaboration*', which drew attention to certain exemptions and exceptions under competition law that could apply (for example, those relating to pro-competitive outcomes, de minimis arrangements and block exemptions). It also argued that collaboration has been '*elevated from being a matter of general practice to a statutory obligation*' by virtue of the definition of the 'principal objective' in section 9A of the Petroleum Act 1998 (as amended) as being the objective of maximising the economic recovery of UK petroleum, partly through '*collaboration among [relevant] persons*'.

Secondly, and more substantively, collaboration is the focus of SE-09 Collaboration, the corresponding Implementation Guide and the OGA's associated Collaboration Behaviour Quantification Tool, which is intended to assist the industry in understanding how the OGA will implement and assess progress. Companies are expected to be able to evidence internal and external steps taken to create and take maximum advantage of a strong culture of collaboration. They will be required (in conjunction with the OGA) to conduct and document an assessment of collaborative behaviour using a recognised '*collaborative behaviour assessment tool*', and to prepare an action plan to improve the poorest collaborative working areas, to be completed at JV OpCom level.

Activity

Information gathering

Asset Stewardship Survey

One of the OGA's earliest tasks has been to try to establish a 'base line' of reliable industry information against which it can measure the industry (and its own) progress. It consolidated nine industry surveys by various bodies into one annual UKCS Stewardship Survey, to benchmark companies' activities against their peers' and to gather the data it needs to build economic models and inform its area plans. The first Survey returns were required from industry in February 2017. The data gathered was also used to inform the OGA's Stewardship reviews; in order to prioritise these based on delivery performance against MER UK standards.

Information publishing

The OGA wishes to make as much data openly available as possible. It has undertaken several significant data releases, including the publication of a suite of seismic and subsurface data, UKCS-wide multi-satellite gravity data, along with around 140 mature area-related packs, some of which include 'technical montages', on undeveloped discoveries along with regional geological maps covering the Central North Sea and Moray firth.

Consultation on Information Retention and Disclosure

In July, the OGA announced the launch of a consultation seeking industry views on proposed regulations relating to the retention and public disclosure of petroleum-related information and samples. Several of the OGA's information and samples powers under the Energy Act 2016 were brought into force in December last year. Under section 34 of the Act, the OGA may serve a notice on relevant persons requiring them to provide the regulator with '*any petroleum related information, or a portion of any petroleum related sample*' (as defined, rather widely, in section 27 of the Act) held by or on behalf of that person. To compliment these powers, the Secretary of State is able to regulate on what industry will be required to retain, in what form, and for how long, along with what information and samples the OGA will be able to disclose, and the time period after which that disclosure can take place. The OGA's consultation on the proposed regulations is due to close on 25 August and further regulations are anticipated thereafter.

(NB. The sections of the Energy Act 2016 relating to production of information and sample plans and appointment of an information and samples co-ordinator are not yet in force.)

PPRS and the Information Management Strategy

In late February 2017, the OGA announced its intention to launch a refreshed Petroleum Production Reporting System ('**PPRS**') during Q2 2017, to replace the current 'PPRS 2000' and improve the system's functionality and capability. Currently, monthly data from onshore and offshore fields and terminals is submitted by the operator via email to the OGA. The data is then loaded onto PPRS and placed in the public domain on the OGA's website after three months. In contrast, the new system will operate more efficiently by allowing operators to load the data directly into the application. Standard data validation rules will also feature, along with enhanced tools for the OGA to monitor data quality and submission, and a new interface for operators.

Area Plans

Under the MER UK Strategy, the OGA has the option of utilising 'OGA Plans' to set out its view on how any of the obligations in the Strategy may be met. However, despite the raft of further sub-strategies and guidance, it was not always clear what form these plans might take, or indeed whether they would be used at all. The OGA provided clarification in August through its 'Guidance on the Development and Use of Area Plans'. According to the Guidance, there are three types of plans: (1) Area plans, developed between the OGA and industry regarding how economic recovery should be maximised in a particular geographical area; (2) MER UK Plans, being those referred to as 'OGA Plans' in the Strategy; and (3) Regional Strategies, being a group of Area Plans in a specific region.

The Area Plan Guidance sets out a prescribed form which the Area Plans are to take, and details the potential level of OGA involvement at each of the 'Initiate', 'Work', and 'Execute' phases. All parties will be required to cover their own costs of involvement in all phases of an Area Plan. OGA states that the Plans are '*not intended to guarantee commercial returns for participants*', but are instead intended to demonstrate achievement of the principal objective and the meeting of MER UK obligations, required actions, and behaviours. No further guidance has yet been provided in relation to the MER UK Plans.

Sanctions

So far the OGA has not imposed any sanctions, although it has made clear it does not consider sanctions to be a last resort and it will be prepared to do so in the appropriate circumstances. In its April 2017 Board Minutes, the OGA reported that '*the case review process is working well and is proving effective in resolving cases before sanctions are considered. To date, just one case has been transferred from operations to regulation*'. Pending further detail and real world examples, industry's understanding of the OGA's approach to sanctions rests primarily on the OGA's Sanctions Procedure Guidance, which sets out the steps (from Enquiry through Investigation to formal Board Decision on the issuing of a Sanction Notice) that it will take in order to consider any proposed sanctions.

More detail is available regarding financial penalties, in OGA's Financial Penalty Guidance. The Energy Act 2016 required the OGA to consult on the matters to which it will have regard when determining the level of financial penalty to be imposed by a financial penalty notice, and the Guidance is the result of that consultation. OGA intends a financial penalty to be: effective in addressing the underlying cause of the failure to comply; dissuasive of future failure to comply; and proportionate to the significance of the failure in the context of the petroleum-related requirement and the impact on the relevant person(s).

Fees & Levy

In late 2016, the OGA consulted on proposals to introduce new OGA fees and amend the methodology to calculate the industry levy. Implementing the latter, the Oil and Gas Authority (Levy) Regulations 2017 came into effect on 1 April 2017; the OGA's proposal to BEIS, that new direct fees for its activities should be introduced as early as possible in the 2017/2018 financial year, has not yet been implemented.

Licensing

The OGA has conducted two licence rounds since its powers came into effect on 1 October 2016, having opened the 30th Offshore Licensing Round on 25 July this year.

It is also keen to ensure that the licences awarded focus efforts on achieving MER UK. To that end, the OGA has proposed changes to the model clauses for Seaward Production Licences, including amending the date on which a licence is considered to have commenced, adding new termination provisions, and introducing an entirely new type of licence: the 'Innovate Licence', which would permit applicants to propose a staged Work Programme and a bespoke Initial Term. Launched - at least in part - in the 29th Offshore Licensing Round, this new concept is intended to allow for greater collaboration between licensees and the OGA. Whilst elements of the 'Innovate' notion were introduced in the 29th Licensing Round, the OGA considered that the full benefit of the concept could only be realised through amendments to the model clauses contained in the Petroleum Licensing (Production) (Seaward Areas) Regulations 2008. A consultation on those proposed amendments closed on 6 January and an OGA response was issued on 21 April. The proposals have now been published in the form of new draft clauses issued alongside the 30th Licensing Round, but these have yet to be formally implemented.

Industry Codes of Practice

First published in 2002, the Commercial Code of Practice ('**CCOP**') was designed to promote co-operative value generation by means of best practice commercial processes and senior management commitment. Given its emphasis on collaboration, CCOP was an obvious area for early consideration by the OGA. With OGA and industry input, CCOP has now been updated, so that the 2016 version contains many references to OGA and express provisions to ensure compliance with the obligations and expectations of the MER UK Strategy.

Although the new CCOP is not directly enforceable (it is, after all, still in name a voluntary agreement), failure to comply with CCOP may be taken into account by the OGA in considering whether or not a relevant person is behaving in a manner which is MER UK compliant. A perceived failure to collaborate risks being interpreted as a sanctionable failure to comply with the MER UK Strategy.

An update of the Industry Code of Practice ('**ICOP**') on Access to Infrastructure is in progress.

'Lessons Learned'

The OGA has published a report examining major oil and gas projects in the UKCS over the last five years: 'The Lessons Learned from UKCS Oil and Gas Projects 2011-2016'. This considered 58 major projects carried out between 2011 and 2016, identifying what could be done to improve cost and time efficiency in delivery of big offshore projects. Its principal findings included the fact that fewer than a quarter of oil & gas projects were delivered on time, and on average these were delivered 10 months late and 35% over budget.

The findings themselves played a key role in developing one of the ten Asset Stewardship Expectations: SE-05 Robust Project Delivery. This Expectation focuses on robust project delivery and imposes upon operators an expectation to deliver major capital projects as per the cost and schedule commitments made at the time of FDP approval.

Decommissioning

Where decommissioning is concerned, the OGA has published a report providing its own estimate of the cost of decommissioning oil and gas assets on the UKCS. The 'UKCS Decommissioning 2017 Cost Estimate Report' was produced using data from the UKCS Stewardship Survey, and attempts to provide a probabilistic cost estimate. The OGA calculates the P50 cost of decommissioning at £59.7 billion in 2016 prices, although the full range of probabilistic estimates runs from £44.5 billion to £82.7 billion. Its stated goal is to reduce decommissioning costs based on this P50 estimate by 35% to £39 billion. The OGA is likely to focus its cost reduction efforts on well P&A, topsides removal and post cessation of production operating

costs. Operators may find pressure to apply those standard cost estimation methodologies, share information and adopt new technologies.

Forward Looking

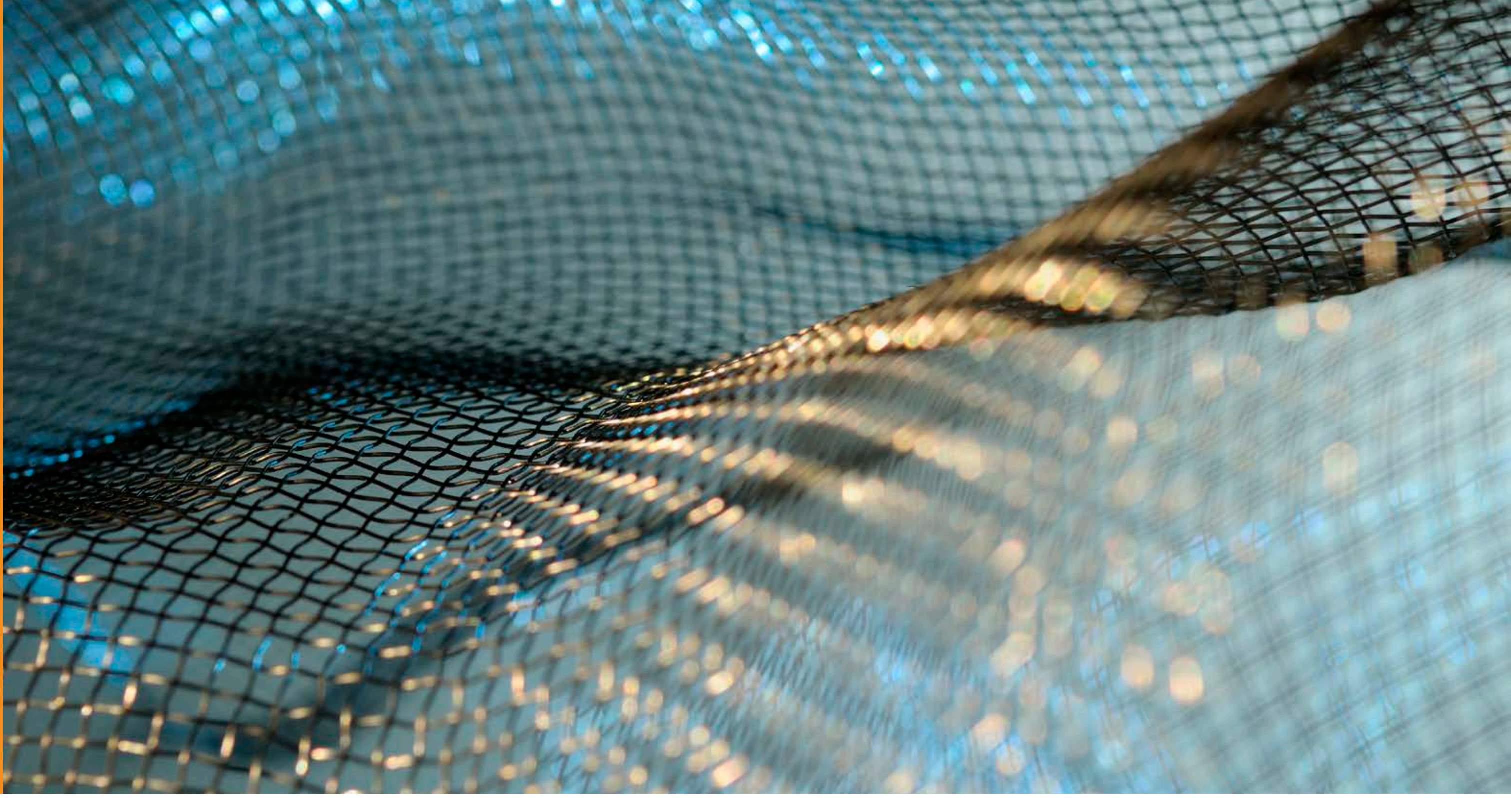
The OGA's Activity Plan for 2017 and 2018 builds upon the strategic priorities and operating framework described in its Corporate Plan 2016-2021. Using the same broad 'Priority Areas', the Activity Plan updated the associated milestones and targets for each activity area over the next 24 months. There are seven high-level priorities, and the OGA has developed a set of 'top ten' programme priorities for 2017 and 2018. These include, for instance, the '*appropriate use of powers to maximise economic recovery*'; '*inform[ing] UK Government's Industrial Strategy*'; and '*driv[ing] investment, efficiency and new business models*'. Achievement against each is measured by way of detailed KPIs, which suggest that the OGA's specific focus may have shifted somewhat compared against the Corporate Plan KPIs, from an initial focus on establishing processes towards tracking how effective those processes are.

The OGA reports that, during 2016 – 2017, 102 success stories were recorded across its activities, although no examples or specific details are provided. A unit of success in this area is, however, difficult to quantify. The OGA proposes that its success ought to be measured relative to what would have happened in the absence of support and/or intervention. In that regard, it has developed three measurement tools: a success stories tracker, a dashboard, and its own success quantification methodology. These metrics consider '*expected future volume of oil and gas production, capital expenditure committed to new projects, and reduced or avoided costs through improved or accelerated outputs*'. It suggests that the successes to date translate to 700 million, or £110 million of cost savings, or £640 million of investments.

The OGA's progress may also be assessed financially. In setting the budget for the 2016-17 financial year, the OGA's intention was to raise revenues of £25.3 million: £21.3 million through industry levy, £3 million as a contribution from BEIS, and direct fees and charges of £1 million. The OGA's Annual Report states that a higher than expected volume of chargeable work was undertaken, resulting in revenues higher than projected. Expenditure for the year was also underspent by £78,000, which is to be repaid to licensees as a levy repayment.

Other tasks the OGA is focussed on for 2017 include updated guidance for regulatory documentation to improve field information and an industry engagement plan describing how the OGA will capture decommissioning lessons learned from the industry.

Although we are now better placed to understand the OGA's MER UK intentions, it is yet early days for the industry's new regulatory regime. There are many new issues and fresh ways of working to consider and their true implications may only become clear after the industry has had time to see how implementation of the OGA's many requirements helps or hinders their day-to-day work.



Innovation in a low oil price environment

The low oil price environment continues to shake up an industry that now looks very different to how it did prior to 2014. This 'new normal' has led to widespread innovation and structural change across the industry. Here we examine the re-emergence of innovative models of contracting that are being implemented by oilfield service companies and the creative approaches that are being taken in the structuring of M&A deals.

Innovative contracting models implemented by Oilfield Services Companies ('OSCs')

Depressed oil prices have been particularly punishing on OSCs. Revenues have fallen as exploration and production ('**E&P**') company clients sharply reduced capex and looked to re-negotiate, and in some cases terminate, contracts for services and equipment. OSCs have responded to challenging market conditions by seeking out efficiency savings and making reductions in capex and employee headcount.

Some OSCs have sought to weather the current market and increase their resilience against future oil price cycles through merger and acquisition activity. GE cited up-scaling and the streamlining of complementary service offerings as key factors in its decision to acquire Baker Hughes in 2017. Schlumberger’s 2016 acquisition of Cameron International sought to combine complementary expertise in surface and sub-surface technology. Earlier this year, Wood Group announced its £2 billion acquisition of Amec Foster Wheeler (Foster Wheeler itself having been taken over by AMEC in 2014).

In parallel to consolidation in the OSC market, there has been an emerging trend of OSCs turning from traditional contracting models to more innovative, collaborative arrangements. In essence, this has involved OSCs pursuing more risk-based or 'equity-style' commercial arrangements.

Traditional models of contracting
The traditional model of contracting between an OSC and E&P company client is the 'fee for service' arrangement, under which an OSC is remunerated either on a fixed basis or on the basis of its performance, usually with reference to certain key performance indicators ('**KPIs**').

'Quasi-equity' commercial models
In contrast to traditional models of contracting, more innovative incentive-based models have developed that link remuneration to the success of a project, rather than to the performance of the OSC; this is sometimes referred to as 'quasi-equity'. Such incentive-based arrangements can increase value for all parties, reducing costs and reinforcing collaboration by requiring all parties to share in the losses and gains from a project.

One trend, similar to buyer to seller loans (discussed below in an M&A context), is larger OSCs looking to effectively wrap the development of an asset on behalf of a (often smaller) E&P company or on behalf of a national oil company ('**NOC**') in exchange for an equity style return. For example, a high net rate of return on the capex investment together with a royalty/net profit interest ('**NPI**'). As the OSC will not take a share of production, such models stop short of being 'pure' equity. The further upside for the OSC is that it effectively locks in the provision of services and equipment for such development (subject always to competition and local content requirements).

The financing of some elements of new field developments by OSCs has come in part as a result of invoice deferrals until after first production, or in some cases, production-related payments following first production. A quasi-equity style commercial model will often be bespoke and is typically determined by the nature of the project, the jurisdiction in which the project is located and level of risk assumed by the parties. However, we see the smaller E&P companies with high capex requirements open to such innovative solutions rather than the bigger players in the industry. Such an arrangement will also generally be entered into by the operator of the asset; therefore, buyers of non-operated interests will struggle to access arrangements like these except in conjunction with the operator.

Comment on innovative contracting models
The adoption of quasi-equity models by OSCs is nothing new; such arrangements were implemented in the North Sea in the 1990s, as OSCs entered into partnering arrangements, alliances and gain-sharing agreements with E&P companies. While international oil company ('**IOCs**') and NOCs will continue to demand high-quality standalone services and equipment from OSCs, creative and innovative approaches to contracting will be a key tool for OSCs as they are tested by current and future oil price cycle volatility.

As a more general trend, the move to equity-style contracting arrangements can only be aided by the rise in influence of NOCs, which have vastly overtaken IOCs to control the majority of global reserves and are, relatively, more resilient to oil price cycles. That NOCs can afford to take a longer term view of projects, and are increasingly pivoting from maximising volume to generating long-term value, make them an attractive partner for OSCs in equity-style contracting arrangements.

While oil prices show little sign of recovery in the short term, the success of OSCs in a challenging market will be, at least in part, influenced by first-mover advantage of pursuing equity-style models of contracting and calculating an optimal mix of quasi-equity and equity contractual arrangements in their portfolios worldwide.

Innovation in oil and gas M&A deals

What has become clear from recent completed, signed and attempted M&A transactions is that innovative solutions are required in order to overcome hurdles which have prevented deals from signing or closing in the past. The traditional approach to oil and gas acquisitions will not be workable in many cases. Here we briefly explore some of the key developments in asset M&A, focusing on (1) mechanisms to help bridge the value gap between buyers and sellers; and (2) new financing structures.

Closing the value gap between buyers and sellers
Deferred or contingent consideration structures are becoming more common in sale and purchase agreements to allow for sharing of elements of upside or downside. These structures often include one or more of the elements outlined below:

(i) Additional consideration payments based on forward oil price
This is a relatively straightforward model for bridging the valuation gap, especially where contingent payments are not linked to field production. Under this structure, the buyer's consideration is increased where the forward oil price is higher than a certain threshold; sometimes, if the forward oil price is lower than a certain threshold then the seller may be required to make a payment to the buyer.

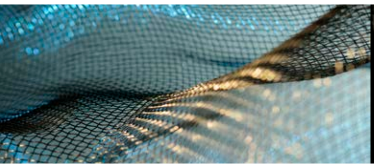
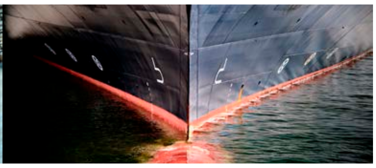
(ii) Additional or contingent consideration linked to future production
This approach can be problematic for sellers given that the buyer, and not the seller, will have 'control' of the asset in question. In this arrangement, documentation would need to provide the seller with access to relevant field information. Where the asset is owned by a joint venture, that information may be confidential under the operating agreement meaning that the parties require consent from co-venturers in order to allow information flow to the seller.

If the model focuses only on production (and not costs) there is a risk that the buyer might be obliged to make payments to the seller in circumstances where the asset is losing money. The payment could even render continued production uneconomic from the buyer's perspective.

(iii) Deferred consideration payable on field development approval
These models appear simple but there are a number of issues to be considered. Where payment is linked to field development approval, the following questions ought to be considered:

— Is the payment triggered in circumstances where the buyer has not approved or is not participating in the approved development? This may arise where the buyer's co-venturers opt to sole risk a development under the operating agreement without the buyer's participation. Alternatively, the licence could be relinquished (because the acreage is not developed), the acreage relicensed and subsequently developed by the new licensees; and

— can the payment be avoided as a result of the buyer onward selling the interest prior to field development approval?

(iv) Seller retention of royalty or NPI
When drafting royalty/NPI arrangements the seller may be concerned about avoidance/gaming by the buyer. Therefore great care must be taken to clearly identify all the revenues/costs that will be taken into account in determining the payments due to the seller. The buyer will want to ensure that the seller's return is not enhanced because revenues are overplayed or certain costs cannot be taken into account in the calculations.

Some of the issues to be considered in determining payments under this model include: the valuation of receipts; the inclusion of third-party tariff receipts; the treatment of insurance proceeds received by the buyer; the implications of the buyer's net income from the asset becoming negative for one or more calculation periods; decommissioning costs; any relevant government consents; and the likelihood of the seller gaining access to relevant field information.

(v) Sales on a tranche basis with buyer option to buy further interest(s)
This structure may be attractive in circumstances where the buyer is not in a position (or is not prepared) to acquire the entire interest at the outset; the buyer may then use profits from the initial acquisition to fund subsequent tranches.

Under this model, the seller will be locked into the option for a fixed period. As a result, it will be unable to sell the residual share to a third party until the option expires. This structure may require multiple transfer processes and may be rendered unattractive where there is a large involvement of relevant third parties. In addition, particular care should be exercised when drafting any pre-emption provisions in the asset operating agreement where this model is adopted.

New financing structures
This year we have already seen some new money reserve-based lending. However, since the price downturn it has generally been difficult for buyers to access debt finance. As a result we have seen and been involved with a number of novel alternative arrangements to allow buyers to access cash in order to undertake M&A transactions and fund field developments/work.

(i) Loans from sellers to buyers
The recent Shell deal in the UKCS involved elements of seller finance and repayment in order for the buyer to be able to fund the acquisition.

(ii) Loans from buyers to sellers
These have been a feature in the past where smaller E&P companies farm out an interest in a key development asset.

(iii) Forward sales of hydrocarbons and offtaker loans
Lending companies such as Flowstream, trading arms of some oil majors, and, more globally, trading companies such as Vitol, Glencore and Trafigura have been involved in transactions where they have either acquired or at least lent against (via a prepayment facility or similar product) future production from a field owner for an upfront consideration, thus injecting significant capital into the field owner that can be used to fund other transactions. These arrangements may require government approval under the relevant licence or PSC.

Documentation would need to provide the lender with access to relevant field production information. Where the asset is owned by a joint venture that information may be confidential under the operating agreement, the parties would require consent from co-venturers in order to allow information to flow to the lender.

(iv) Sale and leaseback
Oil companies looking for capital have been able to sell and leaseback some offshore infrastructure or onshore real estate from some finance providers. Oil and gas assets are routinely owned by joint ventures and assets will generally be joint property owned by the parties to the joint venture. In practice, it can be difficult for individual owners to enter into arrangements like this in respect of their percentage interest in the asset. This option has been more common for floating infrastructure such as FPSOs and FRSUs, which are often financed separately, and where the benefits of such financing for all underlying joint venturers may be clearer.

Security in innovative financing models
There are significant hurdles in structuring such new financing arrangements, particularly around security. One key hurdle is that E&P companies will often have already given some form of first-ranking security to existing lenders. As a result, such arrangements, particularly those which constitute financial indebtedness, may require the consent of the existing lenders.

Buyers may be able to create security over their interests in the relevant operating agreement and licence. While this would give the lender an advantage over other creditors but in a default scenario, the rights of co-ventures (i.e. forfeiture) could trump the security given to the lender.

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